Nos. 12,618 and 12,619

IN THE

United States Court of Appeals

For the Ninth Circuit

MOLLY A. HARKNESS, *Petitioner,* vs. COMMISSIONER OF INTERNAL REVENUE, *Respondent,*	No. 12,618
	(CONSOLIDATED CASES)
FLOYD J. HARKNESS, *Petitioner,* vs. COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	No. 12,619

BRIEF FOR PETITIONERS.

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BRIEF FOR PETITIONERS.

STATEMENT OF JURISDICTION.

This matter comes before this Court on the petition for review of Molly A. Harkness (R. 285-303) of a decision by the Tax Court of the United States (R. 249-284) determining deficiencies in income and victory taxes for the calendar year 1943, which deficiencies against the Petitioner, Molly A. Harkness, were in the sum of Sixty-four Thousand Six Hundred Sixty-six Dollars and Sixty-four Cents ($64,666.64), and

the petition for review of Floyd J. Harkness (R. 16-34) of a decision by the Tax Court of the United States (R. 15) determining deficiencies in income and victory taxes for the calendar year 1943, which deficiencies against the Petitioner, Floyd J. Harkness, were in the sum of Sixty-five Thousand Two Hundred Fifty-two Dollars and Twenty-seven Cents ($65,-252.27).

It was stipulated by and between the parties, through their respective counsel, that these petitions be consolidated, and that for the purposes of said consolidated petitions the parties will rely upon the record in "*Molly A. Harkness,* Petitioner, vs. *Commissioner of Internal Revenue,* Respondent", No. 12618 (R. 316).

It was further stipulated by and between the parties, through their respective counsel, that these petitions be consolidated for the purposes of brief, argument and opinion (R. 316-317).

Opinion Below.

The opinion and decision of the Tax Court is reported in 13 T.C. 1039, and is set forth at length on pages 249 to 284 of the Record.

Jurisdiction.

Jurisdiction and venue in this Court are predicated upon Sections 1141, as amended, and 1142, Internal Revenue Code. These petitions for review were filed on May 12, 1950 (R. 304), within three months after the Tax Court's decision on February 15, 1950 (R. 284).

Petitioners' income tax returns for the calendar year 1943 were filed with the Collector of Internal Revenue for the First District at San Francisco, California (R. 250).

Jurisdiction of the Tax Court is predicated upon Sections 272(a) and 1101, Internal Revenue Code. The petitions for redetermination were filed on November 10, 1947 (R. 28), within ninety days after Respondent's notices of deficiencies to Petitioners were mailed on August 21, 1947 (R. 9).

STATEMENT OF THE CASE.

The Petitioners are husband and wife. They are residents of Fresno, Fresno County, California (R. 105).

On August 21, 1947, the Respondent determined deficiencies in income tax liability for the taxable year ended December 31, 1943, against the Petitioners in the aggregate amount of One Hundred Twenty Thousand One Hundred Forty-eight Dollars and Ninety-one Cents ($120,148.91) (R. 250).

This determination arose by reason of the inclusion by the Respondent in the Petitioners' taxable income for the taxable year 1943, on a community property basis, of all of the income from the operation of a partnership composed of Petitioners, their son, Floyd J. Harkness, Jr., and their daughter, Harriet Harkness Colgate (R. 272-273). This partnership does business under the firm name and style of United Packing Co.

During the taxable year in question, each of the partners owned a twenty-five per cent interest in the partnership.

After the Respondent had made his determination of deficiencies, the Petitioners applied to the Tax Court for redetermination. The Tax Court heard Petitioners' petitions for redetermination on January 11, 1949 (R. 82). The petitions were consolidated for hearing (R. 83), and were submitted to the Tax Court for decision upon a written stipulation of facts (R. 30-36), the oral testimony of four witnesses and certain Exhibits. After having considered the evidence, the Tax Court affirmed the Respondent's determination.

The sole issue is whether a valid and bona fide partnership existed between Petitioners and their children for the taxable year 1943 for Federal income tax purposes.

In the summary of the facts that follows, we have incorporated verbatim the findings of fact of the Tax Court. We have, however, in so doing, deleted ultimate findings and conclusions which are clearly erroneous. These deletions will be indicated where they occur by asterisks and the deleted material will be set forth in footnotes. In order to complete the summary, we have added at the conclusion of the Tax Court's findings, material facts with respect to which the Tax Court made no findings.

Summary of the Facts.

(a) The Facts Found by the Tax Court.

"Petitioners, Floyd J. Harkness and Molly A. Harkness, are individuals residing in Fresno, California. They filed their separate income tax returns for 1943 with the Collector of Internal Revenue for the First District of California. Petitioners were married July 14, 1915, and have made their home in California ever since. They have two children, Floyd J. Harkness, Jr., and Harriet Harkness Colgate, born in 1918 and 1920, respectively" (R. 250-251).

"Harkness, Sr., has been a grower and shipper of fruits and vegetables since 1918. Prior to 1937 he engaged in this occupation first as an employee of various concerns and then as a member of two successive partnerships operating under the name of United Packing Co. In January, 1937, Petitioner bought out his partner and commenced operating the business as a sole proprietorship under the same name. Molly Harkness, as his wife, owned the assets of the business in community with him. The company specialized in packing and shipping cantaloupes, carrots, peaches, plums, nectarines and grapes. Some commodities were raised by the company itself while others were bought from farmers on a cash basis. Still other produce was packed and shipped by the company on a commission basis. For the purposes of its business United Packing Co. operated ranches and packing houses, and manufactured and stocked packing materials. Its main office was located in Fresno, but its operations covered a large area in the San Joaquin Valley extending

northward 138 miles to Lodi and southward 127 miles to Arvin. At the close of 1942 the gross proceeds and net income earned by United Packing Co. amounted to $1,468,119.64 and $141,790.95, respectively" (R. 251).

"During the years up to 1942 Petitioners' two children were occupied primarily in obtaining an education, though each performed some services in their father's business. Harkness, Jr., attended schools until June, 1941, when he graduated from college with a major in commerce. From 1934 until 1941 he worked in his father's business during summer vacations and in 1937 he quit school for six months to help his father launch the sole proprietorship. From June, 1941, until January, 1942, he devoted his full time as an employee of United Packing Co. working as a 'regular field man' at a salary of $150 per month plus a five per cent bonus of approximately $910. During this six months' period he also earned four to five thousand dollars in independent deals in the fruit and vegetable business. On January 12, 1942, he entered the United States Air Corps as a private. At the close of 1942 Petitioners' son still had a credit on the books of the sole proprietorship of $1,412.05 for prior services performed. He owned no substantial property outside of these earnings at that time" (R. 251-252).

"Harriet Harkness finished her schooling in June, 1942, when she graduated from college. During summer vacations she had occasionally performed secretarial services in her father's business. Harriet worked full time as a secretary at United Packing Co.

from June until August, 1942, at which time she married William H. Colgate, Jr., who was then serving in the United States Army. Following her marriage she spent her time housekeeping for her husband at various military posts in the United States until October, 1944. She owned no significant amount of property at the time of her marriage.

"Harriet's husband, William Colgate, had resided in Fresno County, California, all his youth and had been an acquaintance of the Harkness family for a number of years prior to his marriage in 1942. He attended college, majoring in commerce, and during summer vacations was employed by the Peerless Pump Company, the largest supplier of irrigation pumps in the San Joaquin Valley. Colgate later quit school and worked full time for this company for nine months before enlisting in the United States Army in March, 1941. This was in keeping with his desire to devote his career to agricultural pursuits in the Valley. As an assistant foreman aiding in the installation of extensive irrigation systems, Colgate acquired considerable knowledge of the mechanics of irrigation. After his marriage to Harriet, they were stationed at Columbus, Ohio, during the latter part of 1942 and throughout 1943" (R. 252-253).

"In the fall of 1942 Harkness, Sr., became convinced that it would be advantageous to convert the operation of his fruit packing and shipping business from a sole proprietorship to a partnership composed of his wife, himself and his two children in the coming year. Many reasons dictated that decision. Pri-

marily he desired to obtain the services of his son and son-in-law in the business. He felt that as a result of their college education and the practical experience they had gained pursuing agricultural employment in the Valley that they would make skilled, competent supervisors capable of overseeing the widespread operations of the company. Secondly, from his experience in the fruit and vegetable packing industry, Harkness believed that it was essential to increase the capital investment in the company by allowing annual profits to remain in the business. This was necessary not only to permit payment of extensive operating expenses, to allow for expansion of the company facilities and equipment and to develop new business, but also to meet the exigencies of bad crop years when the company's income declined drastically. Furthermore, in 1942 fruit packers were anticipating a decline in profits due to labor shortages, low transportation priorities for their produce, and the probability that prices would tumble as in World War I. These circumstances only increased the need for increasing the capital reserve of United Packing Co. Yet it had been Harkness' experience in past years that to hold qualified supervisory personnel it was necessary to pay them large bonuses or percentages of profits which they invariably withdrew from the business and often used to set themselves up in competition with him, thus draining the company's capital. He felt the only way to retain profits in the company was to bring into the business persons who felt as he did. Through long discussions with Harkness, Jr., and William Colgate, Petitioner knew that they agreed with him that only

a reasonable amount of the profits should be withdrawn from United Packing Co. and the rest of the net income should be allowed to accumulate in the business'' (R. 253-255).

"While Harkness, Sr., was well aware that neither Floyd, Jr., nor William Colgate would be available to serve United Packing Co. for the duration of the war and he would be the only active partner in the meantime, yet he desired them to acquire an interest in the company at this time to guarantee their future help in running the business after their release from the Army.

"Furthermore, formation of the partnership accorded with the wish of Harkness, Sr., to give his children an opportunity to make good. Even when Floyd, Jr., was a boy he and his father planned for the day when the former would be a full-fledged partner. After graduation from college in 1941 Harkness, Jr., had pressed his father to give him the status of a partner in the business, and while Harkness, Sr., had too many financial commitments to do so in that year, yet he promised his son he would make provision for him to purchase an interest in the business. Now Petitioner desired to fulfill that promise. It was long understood that if one child was given an opportunity to participate in the business, the other would be given an equal opportunity. Offering Harriet an opportunity to become a partner in his business not only fulfilled this pledge, but was a long step toward securing the eventual services of her husband which Petitioner so greatly desired'' (R. 253-255).

"While Harkness, Sr., consulted a lawyer concerning the feasibility of converting his business into a partnership and was thus aware of the tax-saving possibilities inherent therein, yet this fact was only a secondary consideration with him, and he would have entered into this arrangement regardless thereof.

"During the fall of 1942 Harkness, Sr., held lengthy conversations with his son, who was stationed at a nearby airfield, regarding the proposed partnership. Harkness, Jr., eagerly accepted the chance to buy an interest in United Packing Co. for this had been his great desire for many years and assured him of full participation in the business on his return from the service. Petitioners and young Harkness then definitely planned to convert the business into a partnership starting in 1943.

"Over the same period of time Harkness, Sr., also corresponded with his daughter and offered her either the opportunity to invest in United Packing Co. or some other enterprise. Furthermore, it was understood that if she decided to come into her father's business, her husband, William Colgate, would be allowed to participate in the partnership following his release from the Army. Harriet and William Colgate debated at length whether it was advisable for her to buy an interest in her father's business or invest elsewhere. Finally Harriet exercised her option to procure an interest in United Packing Co. after her husband determined he wanted to be associated with United Packing Co. upon his return from the service.

"Thus, by November, 1942, Petitioners and both their children generally agreed to the formation of a partnership for the operation of United Packing Co. in the coming year, though the details of the partnership relationship had not been worked out. A 'Certificate of Co-Partnership Transacting Business under Fictitious Name' was executed on November 12, 1942, which Petitioners and young Harkness signed on that date and Harriet signed on November 28. It stated that the four were co-partners carrying on business under the name of United Packing Co. and that Harkness, Sr., was the general manager in full charge of all business operations. This certificate was published in a local paper and later filed with the county recorder of Fresno County.

"On December 31, 1942, 'Articles of Partnership,' providing the detailed terms of the proposed partnership, were drafted and met the approval of all but Harriet Colgate, who refused to sign until provisions as to the control of the business and as to purchase of a deceased partner's share were modified" (R. 255-257).

"On January 1, 1943, Petitioners transferred to United Packing Co., a partnership, most of the assets and some of the liabilities of United Packing Co., sole proprietorship, existing on December 31, 1942, resulting in a net worth of $138,241.61 for the partnership on that date. Harkness, Jr., and Harriet Colgate each bought a one-fourth interest in the partnership for $34,560.41, equivalent to one-fourth of its net worth. To pay Harkness, Sr., for his share in the

partnership, the son used $1,392.05 of the credit he had earned as compensation for prior services rendered the sole proprietorship and on January 2, 1943, signed a promissory note for the remaining $33,168.35 with interest at four per cent per annum. Harriet Colgate purchased her partnership interest from her father with a promissory note dated January 2, 1943, for $34,560.40 plus four per cent interest per annum. William Colgate joined her on the note as co-maker * * *''[1] (R. 257-258).

"These transactions were reflected on the books of United Packing Co., copartnership, as of January 1, 1943. It showed assets of $142,861.03 and liabilities of $4,619.92 and a net worth of $138,241.61. Capital of the partnership was stated to be $138,241.61 resulting from contributions of $34,560.41 each from the three Harknesses and Harriet Colgate.

"On January 4, 1943, pending acceptance by Harriet Colgate of the articles of partnership drafted on December 31, 1942, Harkness, Sr., Molly Harkness, Harkness, Jr., and Harriet Colgate signed a supplemental agreement fixing compensation and distribution of partnership profits among the partners. The salary of Harkness, Sr., as general manager of the partnership, was fixed at 75 per cent of the first $100,000 of the partnership net income. There was no provision for salaries for the other partners. The re-

[1] "No collateral was required on either note". This finding ignores that under the terms of the partnership agreement the children pledged the first profits derived from the business to the payment of the notes, and also that the notes were secured by their respective interests in the partnership (R. 263, 119, 121).

mainder of the first $100,000 of partnership net income was to be divided equally among the partners, as were any profits over that amount. Paragraph three of this supplemental agreement stated:

> 'It is understood and agreed that the payment of the 75% of the net income as provided for, is being made to first party on account of the fact that he is the only active co-partner in said business at this particular time and will continue as such during the duration of the present war.'

"During January, 1943, Harkness, Sr., discussed with the Colgates the modifications sought by Harriet Colgate in the partnership agreement drafted on December 31, 1942. Harriet withdrew her objections when the original draft was altered to meet her demands. The reformed partnership agreement was signed by the three Harknesses on February 27, 1943, and by Harriet Colgate on March 10, 1943"[2] (R. 258-259).

"In February, 1943, an undivided one-half interest in a 300-acre vineyard and orchard was acquired by Harkness, Sr., Molly Harkness, Harkness, Jr. and Harriet Colgate as tenants in common. The other half interest in the ranch was acquired by Chris Sorenson and his wife. Sorenson was a supervisory employee of United Packing Co. All funds for purchase of the vineyard were supplied by United Packing Co. and the amount loaned to Sorenson was repaid to the com-

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[2]At this point, the Tax Court quotes in full the partnership agreement. This instrument is set forth in the Appendix to this brief.

pany by him. The fifty per cent interest acquired by the Harknesses and Harriet Colgate was included as an asset of United Packing Co. and subsequent income therefrom was included in its net income. Previously on January 16, 1943, by a bill of sale the personal property on the River Ranch had been conveyed to Chris A. Sorenson and Katherine Sorenson, his wife, and 'Floyd J. Harkness, Molly A. Harkness, Harriet Harkness Colgate, and Floyd J. Harkness, Jr., co-partners, doing business under the firm name and style of United Packing Co., a co-partnership.' Prior to these purchases, all the partners were consulted with respect to them, and Harkness, Jr., who was familiar with the land, approved the transactions" (R. 269-270).

"* * *.[3] Harriet and William Colgate were absent from Fresno until his discharge from the armed services in October, 1944, so consequently she performed no services for United Packing Co. during the year 1943 nor did she participate in the management of its affairs. Throughout the year 1943 until December, Harkness, Jr., was stationed at Hamilton Field, California, approximately six hours traveling time from Fresno, and frequently visited the company's office and packing plants on weekends. While he was unable to participate in the business activities, yet he discussed its problems with his father on these occasions. In December, 1943, Harkness, Jr., went over-

"During the year 1943 there was no change in the operations of United Packing Co. over prior years. The business was still completely under the control of Harkness, Sr." This clearly erroneous finding is contradicted by the findings that precede and follow it.

seas with the Air Corps and did not return to Fresno until January, 1946.

"In 1943 United Packing Co. earned gross proceeds of $2,572,905.53 and a net income of $361,582. In accordance with the terms of the supplemental agreement Harkness, Sr., was paid a salary of $75,000 and Harkess Sr., Molly Harkness, Harkness, Jr., and Harriet Colgate each were credited with $71,645.50 as their respective shares of the profits.

"Harriet's credit on the partnership books was first applied to pay off the principal and interest on her promissory note to Harkness, Sr., in the amount of $35,942.82, and to offset prior withdrawals from her capital account consisting of cash in the amount of $112.97 and sums of $1,070.89 and $31,423.67 paid to the collector of internal revenue. The balance of $3,095.15 which she left in the business at the close of 1943 was withdrawn in 1944 to pay for taxes and personal expenditures. Of the $71,645.50 credited to Harkness, Jr., $34,495.08 was turned over to his father to pay the principal and interest on his promissory note. Of the remaining $37,150.42 which he left in the business in 1943, young Harkness expended $331.58 for his own use in 1944" (R. 270-271).

"United Packing Co. filed a partnership return for the year 1943, reporting a net income of $361,582, compensation of $75,000 paid to Harkness, Sr., and the distribution of $71,645.59 from profits to each of the three Harknesses and to Harriet Colgate.

"Harkness, Sr., and Molly Harkness filed separate income tax returns in 1943. As residents of a com-

munity property state each reported one-half of the total income of $218,291 they together received from United Packing Co. in 1943, or $109,145.50.

"In his notices of deficiency sent to Petitioners Respondent determined that the net income of United Packing Co. for 1943 was $361,823 and that each Petitioner realized one-half of this amount, or $180,916, as community property income. The notice of deficiency sent to Harkness, Sr. stated in part:

(a) On December 31, 1942, you and your wife Molly A. Harkness, together with your two children, Floyd James Harkness, Jr., and Harriet Harkness Colgate, executed an instrument purporting to create a family partnership. Since Floyd James Harkness, Jr., and Harriet Harkness Colgate contributed no capital originating with themselves, rendered no services to the business, and were not required to participate in the control and management of the business under the terms of the alleged partnership agreement, it is held that they did not acquire valid partnership interests in the United Packing Company. Accordingly, profits from the above-named organization are reallocated to you and your wife on a community property basis, thus increasing your taxable income by $71,770.50 as shown below.

Total net profit of United Packing Co.	$361,832.00
Your community one-half share	180,916.00
Amount reported on return	109,145.50
Adjustment—Increase	$ 71,770.50

Similar language was contained in the notice of deficiency received by Molly Harkness.

"* * *"[4] (R. 271-273).

The findings of fact of the Tax Court end with the above quotation from the notice of deficiency transmitted by the Respondent to the Petitioners and with the ultimate finding quoted in the footnote below. It should be noted at this point that neither the Tax Court nor the Respondent found that the Petitioners' children were not the true owners of the capital that they contributed to the partnership. The ownership by Petitioners' children of this capital is conceded by the Tax Court and the Respondent, but the validity of the partnership for tax purposes is disputed solely because, as the Respondent stated in his notices of deficiency, the children "contributed no capital originating within themselves"[5] (R. 272).

It should likewise be noted that the Tax Court, in making its findings, limited itself to a consideration of the evidence relating to the years which preceded the formation of the partnership and to the

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[4]"The three Harknesses and Harriet Colgate had no intent to join together in conducting the business of United Packing Co. as bona fide partners in 1943 and thus their partnership was not valid for tax purposes that year." This ultimate finding is contrary to the findings that precede it and is contrary to the evidence in the record not considered by the Tax Court.

[5]"This indicates a basic and erroneous assumption that one can never make a gift to a member of one's family without retaining the essentials of ownership if the gift is then invested in a family partnership." *Commissioner v. Culbertson*, 337 U. S. 732, 747, fn. 18, 93 L. Ed. 1659, 1668 (1948). The instant case is stronger than the one envisaged by the Supreme Court. Here we are dealing with an unimpeachable sale—not a gift.

first year in which the partnership operated. A substantial portion of the evidence in the record relates to the performance by the parties of the partnership agreement from 1944 to 1948. All of this evidence was admitted without objection on the part of counsel for Respondent, yet the Tax Court made no findings thereon. This evidence discloses that Petitioners and their children intended to and did join together in conducting the business of United Packing Co. as bona fide partners in 1943 and in all subsequent years.

(b) The Facts Which the Tax Court Did Not Consider.

In the fall of 1944, Harriet Colgate and her husband returned to Fresno, and Colgate immediately went to work for the partnership. He worked under the supervision of Sorenson a very short while (R. 129, 153, 217-218). Thereafter, when Sorenson left the employ of the partnership, on January 15, 1945, William Colgate became the fifth partner in the enterprise. This is evidenced by a supplemental agreement dated January 16, 1945 (R. 37-40, Ex. 2-B). As of that date, Colgate and his wife each became the owners of an undivided one-eighth interest in the partnership. This supplement provided that Colgate would be employed as a field man, receiving for his services the usual field man's salary, and further provided that this arrangement with Colgate was to continue in full force and effect until the return of Harkness, Jr. Ever since the fall of 1944, Colgate has continuously rendered services to the partnership, and since January of 1945 has been in

charge of the operations of the partnership in the Sanger-Clovis area (R. 129, 217-222).

In January of 1946, Harkness, Jr., was discharged from the Army and returned to Fresno, and forthwith began to render services to the partnership (R. 128, 229, 240-241). On January 11, 1946, the partners executed a further supplemental agreement. This supplement provided that Colgate should receive as compensation 25% of the net profits derived from operations in the Clovis-Sanger districts and 25% of the net profits derived from any other deals actively supervised by him. Under the terms of the supplement, Harkness, Jr., was appointed assistant manager of all operations and his compensation was fixed at 25% of the net proceeds of the partnership. The supplement also reaffirmed the provision fixing the compensation of Harkness, Sr., at 75% of the first $100,000 of partnership net income, which, as set forth in the supplement of January, 1943, was to be in effect only for the duration of the war (R. 75-77, Ex. 8-H). Harkness, Jr., has ever since January of 1946 continuously rendered services to the copartnership as assistant manager (R. 230, 240-243).

The foregoing facts show that Petitioners' son and son-in-law performed their commitments to render services to the partnership when it became possible to do so. The facts that follow show that the parties complied with their agreement to increase the capital of the partnership and that Petitioners' children had full and untrammeled control of their share of the partnership income.

Exhibit "6-F" attached to the stipulation of facts (R. 55-68) accurately reflects the condition of the books of account of the partnership in so far as the capital accounts of the five partnerships are concerned. This exhibit shows that, whereas the partnership had a net worth of $138,241.61 at its inception, it had, as of December 31, 1947, a capital of approximately $260,000.00. This Exhibit discloses that, as of December, 1944, from accumulated and undistributed profits earned in 1943, including profits from the "River Ranch", the partners made the following contributions to increase the capital of the partnership: Floyd Harkness, Sr., and Molly A. Harkness, $60,879.19; Floyd J. Harkness, Jr., $30,439.60; Harriet and William H. Colgate, $30,439.60.

Exhibit "6-F" also shows that as of December 31, 1947, Petitioners had as capital, undistributed profits, and salaries payable to them of $385,367.58, as compared to $105,688.12 for Harkness, Jr., and $121,650.11 for Harriet Colgate and her husband.

Exhibit "6-F" also clearly shows that there has been a proportionate distribution of earnings to the members of the partnership. This Exhibit speaks for itself, but for the convenience of the Court and for the further purpose of demonstrating that not only have such distributions been made on paper, but have in fact been made, we are submitting for the Court's consideration summaries of analyses of the capital accounts of Floyd J. Harkness, Jr., and Harriet and William H. Colgate for the period 1943-1947.

Summary of Analysis of Disposition of Income of Floyd J. Harkness, Jr.

Gross Income:		
Salary (1946-1947)	$111,619.88	
Profits (1943-1947)	220,120.15	
Other credits to account	8,040.05	
Total gross income		$339,780.08
Disposition of Gross Income		
Taxes:		
Collector of Internal Revenue (1943-1947)	$106,515.98	
State income taxes (1943-1947)	7,568.84	
Total taxes		$114,084.82
Gross income after taxes		$225,695.26
Disposition of Gross Income After Taxes:		
Payments on Note and Contributions to Capital:		
Payment of principal and interest to petitioners December 31, 1943	$ 34,495.08	
Additional contribution to partnership capital, December 31, 1944	30,439.60	
Total payments		$ 64,934.68
Balance of gross income		$160,760.58
Disposition of Gross Income After Payment of Note and Contribution to Capital:		
Salary and Miscellaneous Withdrawals:		
Salary withdrawals (1946-1947)	$111,619.88	
Miscellaneous withdrawals (1943-47)	9,864.63	
Total withdrawals		$121,484.51
		39,276.07
Balance in account on January 1, 1943		1,412.05
Balance December 31, 1947		$40,688.12

Summary of Analysis of Disposition of Income of William H. Colgate and Harriet Harkness Colgate (1943-1947)

Gross Income:		
Salary (1944-1947)	$ 88,408.24	
Profits (1943-1947)	220,120.15	
Other credits to account	3,994.00	
Total gross income		$312,422.39
Disposition of Gross Income		
Taxes:		
Collector of Internal Revenue (1943-1947)	$ 84,954.08	
State income taxes (1943-1947)	4,297.30	
Total taxes		$89,251.38
Gross income after taxes		$223,171.01
Disposition of Gross Income After Taxes:		
Payments on Note and Contributions to Capital:		
Payment of principal and interest to petitioners, December 31, 1943	$ 35,942.82	
Additional contribution to partnership capital, December 31, 1944	30,439.60	
Total payments		$66,382.42
Balance on gross income		$156,788.59
Disposition of Balance of Gross Income:		
Salary and Miscellaneous Withdrawals:		
Salary withdrawals (1944-1947)	$88,308.24	
Miscellaneous withdrawals (1944-1947)	11,830.24	
Total withdrawals		$100,138.48
Balance December 31, 1947		$ 56,650.11

The Court will observe that, in the case of Harkness, Jr., after his return from Army service, he actually

withdrew $121,484.51 from a gross income, after taxes, of $225,695.26.

In the case of Harriet Colgate and her husband, this summary discloses that, during the period 1944-1947, they actually withdrew $100,138.48 from a gross income, after taxes, of $223,171.01.

These withdrawals, expressed in percentages, show that Harkness, Jr. withdrew 56.5% of gross income, after taxes, and that Harriet Colgate and her husband withdrew 47.6% of gross income after taxes.

SPECIFICATIONS OF ERROR.

1. The following ultimate finding of the Tax Court is contrary to its evidentiary findings:

> "The three Harknesses and Harriet Colgate had no intent to join together in conducting the business of United Packing Co. as bona fide partners in 1943, and thus their partnership was not valid for tax purposes in that year."

2. The ultimate finding set forth in 1. above is based upon a misapplication of the law.

3. The ultimate finding set forth in 1. above is clearly erroneous because it is against the clear weight of the evidence and is arrived at by accepting part of the evidence and totally disregarding other convincing evidence.

4. The following finding of fact is clearly erroneous because it is against the clear weight of evidence and is arrived at by accepting part of the evidence and totally disregarding other convincing evidence:

"During the year 1943 there was no change in the operation of the United Packing Co. over prior years. The business was still completely under the control of Harkness, Sr."

5. The following ultimate finding of the Tax Court is contrary to its evidentiary findings:

"No collateral was required on either note."

6. The ultimate finding set forth in 5. above is clearly erroneous because it is against the clear weight of the evidence.

7. The Tax Court erred in not finding, as the record shows, that Floyd J. Harkness, Jr., upon his return from the Army in January, 1946, was appointed Assistant General Manager of the partnership business, and has ever since that time, and up to January 11, 1949, the date of the hearing of this case, rendered substantial managerial services to the business.

8. The Tax Court erred in not finding, as the record shows, that during the year 1946 Floyd J. Harkness, Jr., received the sum of $57,984.85, and during the year 1947 the sum of $53,635.13, as salary for each of said years for services rendered as such Assistant General Manager.

9. The Tax Court erred in not finding, as the record shows, that during the period 1946 to 1947 Floyd J. Harkness, Jr., withdrew from the partnership business a total sum of $121,484.51.

10. The Tax Court erred in not finding, as the record shows, that William Colgate was discharged from the Army in the Fall of 1944, and immediately went to

work for the partnership, and in not finding that in January, 1945, William Colgate became a fifth partner in the enterprise.

11. The Tax Court erred in not finding, as the record shows, that William Colgate has ever since January, 1945, been the Manager of the Clovis-Sanger District of the partnership and has rendered substantial services of a supervisory and managerial nature to the partnership, and in not finding that he has received the following compensation for his services: 1944, $450.00; 1945, $5,275.00; 1946, $46,554.79; 1947, $35,928.45.

12. The Tax Court erred in not finding, as the record shows, that during the period 1944 to 1947 William Colgate and Harriet Colgate have withdrawn $100,138.48 from the partnership.

13. The Tax Court erred in not finding, as the record shows, as a whole, that Floyd J. Harkness, Jr., and Harriet Colgate were and have been ever since January 1, 1943, the true owners of an undivided interest in the assets of the partnership.

14. The Tax Court erred in not finding, as the record shows, as a whole, that Floyd J. Harkness, Jr., and William Colgate made, as of the date of the formation of the partnership, a commitment to render services to the partnership as soon as circumstances permitted.

15. The Tax Court erred in not finding, as the record shows, that Petitioners and Harriet Colgate and Floyd J. Harkness, Jr., intended to join together

in conducting the business of United Packing Co. as bona fide partners in 1943 and that their partnership was valid for tax purposes for that year.

16. The Tax Court erred in that its decision herein is contrary to the applicable decisions of the Supreme Court of the United States. (*Commissioner of Internal Revenue v. Culbertson,* 337 U.S. 733, 93 L.Ed. 1659 (1949); *Commissioner of Internal Revenue v. Tower,* 327 U.S. 280, 90 L.Ed. 670 (1946)).

17. The Tax Court erred herein in that its decision is contrary to the applicable decisions of the Tax Court heretofore made. (Issac Blumberg, 11 T.C. 663 (1948)).

18. The Tax Court erred in finding, contrary to the record, deficiencies for the year 1943, in lieu of a finding that there is no income tax due from Petitioners for said year.

SUMMARY OF ARGUMENT.

I. This court is fully empowered to review and reverse the Tax Court's decision that the Petitioners and their children did not intend to join together for the purpose of carrying on the business and sharing the profits and losses, in the same manner and to the same extent as a decision of the District Court. Under rule 52 (a), Federal Rules of Civil Procedure as interpreted by the courts, findings of fact by the Trial Court are clearly erroneous if not supported by substantial evidence, and this Court is free to draw its own inference and conclusions from the findings of

fact and the evidence. The Tax Court has disregarded material and uncontradicted evidence and has failed to give effect to many of its own findings of fact. Instead it has made inferences and conclusions unsupported by the evidence and in some instances, inconsistent with its own findings of fact.

II. The Tax Court erred in that its decision is contrary to the applicable decisions of the Supreme Court of the United States.

A. The Tax Court determined that no valid partnership within the meaning of the tax laws existed because Petitioners' children did not contribute original capital or vital services. In this the Tax Court erred because under the teaching of *Commissioner v. Culbertson* (337 U.S. 733, 93 L. ed. 1659 (1949)), the issue is not whether the members of a family partnership contributed original capital, or vital services, but whether the partners really and truly intended to join together for the purpose of carrying on the business, and sharing the profits and losses.

B. The evidence in this case shows that Petitioners' children were the true owners of the capital contributed by them to the partnership, and under the rule of the *Culbertson* case the bona fide intent to join together in a partnership is determined by ascertaining whether the alleged partners contributed services *or capital of which they were the true owners.* The Tax Court did not consider the evidence showing that Petitioners' children were the true owners of the capital contributed by them to the partnership and in this the Tax Court erred.

C. The Tax Court did not give any consideration to the evidence showing the good faith of the parties, and placed its own values on the consideration given by Petitioners' children for their respective shares in the partnership. In this the Tax Court erred. The applicable decisions show that the predominant factor to be considered is the good faith and legitimate purpose of the parties in forming the partnership. The applicable decisions also require, when the evidence discloses that there is room for an honest difference of opinion that the Tax Court refrain from placing its own values on the consideration given for an interest in a partnership. In this case the evidence shows that Petitioners, received ample consideration for the property sold to their children.

III. The Tax Court erred in making findings that are contrary to the record and in failing to consider and make findings on evidence showing the conduct of the parties in years subsequent to the tax year in question.

A. The record contains evidence of events that occurred in the years subsequent to the tax year in question. This evidence was relevant on the issue of good faith. The Tax Court did not consider this evidence in making its findings, and under the applicable decisions this was error.

B. The Tax Court erred in finding that during the year 1943 the business of the partnership was still under the control of Harkness, Sr. This is contrary to the record and fails to give effect to the intent and good faith of the parties.

C. The Tax Court erred in concluding that Petitioners' children did not have unhampered enjoyment of their respective shares of the prof-

its of the business. This conclusion is unreasonable and contrary to the record.

STATUTES INVOLVED.

The applicable provisions of the Internal Revenue Code pertinent to the issue herein involved are as follows:

Sec. 11, *Internal Revenue Code* (26 U.S.C.A. §11)

Normal Tax on Individuals.

> "There shall be levied, collected and paid for each taxable year upon the net income of every individual a normal tax determined by computing a tentative normal tax of 3 per centum of the amount of the net income in excess of the credits against net income provided in section 25, and by reducing such tentative normal tax as provided in Section 12 (c) . . ."

Sec. 22 (a), *Internal Revenue Code* (26 U.S.C.A. §22(a))

Gross Income—General Definition.

> "(a) General Definition. — 'Gross Income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or

use of or interest in such property; also from interest, rent, dividends, securities or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever . . ."

Sec. 181, *Internal Revenue Code* (26 U.S.C.A. §181)

Partnership Not Taxable.

"Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity."

Sec. 182 (c), *Internal Revenue Code* (26 U.S.C.A. §182(c))

Tax of Partners.

"In computing the net income of each partner, he shall include, whether or not distribution is made to him . . .

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183(b)."

ARGUMENT.

I.

ISSUES AS TO THE REALITY OF A PARTNERSHIP WITHIN THE MEANING OF THE FEDERAL REVENUE LAWS ARE FULLY REVIEWABLE BY THIS COURT.

The reality of a partnership within the meaning of the applicable sections of the Internal Revenue Code is dependent upon whether the facts disclosed

by the record show that the parties involved really and truly *intended* to join together for the purpose of carrying on a business, and sharing in the profits and losses or both.

> *Commissioner v. Tower,* 327 U.S. 280, 287, 90 L.Ed. 670, 675 (1946);
> *Lusthaus v. Commissioner,* 327 U.S. 293, 90 L. Ed. 679 (1946);
> *Blumberg v. Commissioner,* 11 T.C. 663, 668-669 (1948);
> *Hirsch v. Commissioner,* 7 T.C.M., 932, 937 (1948).

The issues as to the reality of the partnership herein involved were submitted to the Tax Court on a record which discloses no conflict in the evidence. All the evidence, oral and documentary was presented by the Petitioners. The Respondent offered no evidence to contradict the showing made by the Petitioners. We, therefore, upon submitting the case to the Tax Court argued that the rebuttable presumption in favor of the Respondents' deficiency assessment had been entirely dispelled and that the Tax Court should find that the Petitioners and their children really and truly intended to join together for the purpose of carrying on the business and sharing in the profits and losses. In making our argument to the Tax Court we said:

> "There are involved in this case, as stated heretofore, Sections 22(a), 181, 182, 183 and 3797 of the Internal Revenue Code and the Regulations applicable thereto issued by the Commissioner. These statutes and the Commissioner's

Regulations do not, by their express terms or by the necessary implication therefrom, raise a presumption of liability or bad faith whenever a family transaction is involved. In addition, it should be borne in mind that substance and not form controls in applying income tax statutes, and that the realities of economics and human behavior, rather than the minutiæ of detail which a lawyer inserted or omitted from a partnership agreement, should determine whether a partnership is a sham or a device. (*Doll v. Commissioner of Internal Revenue,* 149 Fed. (2d) 239.) In this connection, we also respectfully point out that there is nothing in the express language of the statutes involved or in the judicial decisions interpreting them which requires the Commissioner to disregard or stigmatize as a sham that most natural of parental impulses—to give the children a better start in life by bringing them into the business.

In the light of the foregoing we contend that the Commissioner cannot, as he has, attempt to make his case solely on the fact that the partnership here in question is cast in the form of an intra-family transaction, but should have established by relevant and material evidence that in substance and in fact it was a sham and a device to escape the payment of income taxes. At this point it appears proper to ask this Court to judicially notice, as it has in the past, that bringing the sons and daughters into the family business and making provision for them is one of the ordinary and natural transactions of life. (*Isaac Blumberg v. Commissioner,* 11 T.C. ——No. 80; *Fischer v. Commissioner,* 5 T.C. 506 at 516.) 'In the ordinary transactions of life,' says a noted

writer on the law of evidence, 'fairness and honesty are presumed, and conveyances, sales and contracts generally are presumed to have been made in good faith until the contrary appears.' (*Jones, Commentaries on Evidence,* Vol. 1, Sec. 13, pp. 99-100.)

The Commissioner did not introduce or offer any evidence to controvert the case made by the Petitioners, and there are no presumptions on which he can rely to make up for his entire lack of proof. At the outset the Commissioner had in his favor the presumption that his assessment was prima facie correct. This presumption of convenience means no more 'than that, in absence of evidence to the contrary, his action will be upheld, but once there is . . . contrary evidence, this presumption vanishes and the case is wide open.' (*Mertens, Law of Federal Income Taxation,* Vol. 9, Sec. 50.71, pp. 296, 297.) This presumption is a so-called 'true' presumption, or a presumption of convenience, and is not regarded as evidence. It is merely a convenient device to shift to the petitioners the burden of *going forward with,* as distinguished from the *actual burden of,* proof. In the instant case, this 'true' presumption ceased to exist when the Petitioners carried the burden of going forward with the proof. Under elementary principles, therefore, we respectfully request this Court to find that the transactions disclosed by the evidence were honest, fair and regular, and that they show an intent on the part of the Petitioners really and truly to form a partnership with their children. (*Mertens,* op. cit. Vol. 9, Sec. 50.71, p. 297; *Cyclopedia of Federal Procedure,* (2d Ed.), Vol. 7, Sec. 3169, p. 191 et seq.; *United States v. Rindskopf,*

105 U.S. 418, 26 L.Ed. 1131.) In making the foregoing statement we are cognizant of the fact that in transactions involving a family or economic unit 'a special scrutiny is necessary.' *Helvering v. Clifford,* 309 U.S. 331, 84 L.Ed. 788; *Doll v. Commissioner, supra.*) We are likewise aware that the Court is not compelled to accept blindly the uncontroverted evidence if it is contrary to common experience. We submit, however, that this last mentioned principle, even if applied with the utmost strictness to the evidence in the instant case, will furnish no basis for the contention of the Commissioner. We say this because we have here a case where the intentions of the parties are well evidenced by the clear terms of the contract entered into, and the acts of the parties prior, and subsequent thereto in carrying out its terms. There is nothing in this uncontradicted evidence which can be said to be contrary to common experience."

We assume that our argument and the record convinced the Tax Court because it accepted the evidence proffered by the Petitioners and made findings thereon showing that Petitioners' children were the owners of the property contributed to the partnership, that the partnership was entered into for good and sufficient business reasons and that tax avoidance was not a primary consideration motivating the Petitioners in making this arrangement with the children. Nevertheless, the Tax Court held the partnership not valid for tax purposes, on the theory that the partnership contract had remained executory or had been frustrated because Petitioners' children had not

contributed during the tax year in question "original capital" and had not rendered "vital services."

This matter was submitted to the Tax Court prior to the Supreme Court's decision in *Commissioner v. Culbertson,* 337 U.S. 733, 93 L.Ed. 1659 (1949), but the Tax Court decided the case after the Supreme Court rendered its decision in that case. In *Commissioner v. Culbertson, supra,* the Supreme Court painstakingly reviewed *Commissioner v. Tower,* and *Lusthaus v. Commissioner, supra,* and other cases bearing on the subject, and after making this review, advised the Tax Court that it could not make findings in cases involving family partnerships by merely applying the objective tests of "original capital" and "vital services." The Supreme Court told the Tax Court that it must make an inquiry into the subjective, and determine the true intent of the parties, and that in determining the true intent it should consider all the facts—"the agreement, the conduct of the parties in execution of its provisions, their statements, the testimony of disinterested persons, the relationship of the parties, their respective abilities and capital contributions, the actual control of income and the purposes for which it is used, and any other facts throwing light on their true intent . . ." *(Commissioner v. Culbertson, supra,* 337 U.S. 742.)

That the Tax Court did not decide this case in accordance with the admonitions of the Supreme Court is clear from a mere reading of the Tax Court's opinion. It is equally clear that it drew erroneous inferences from the uncontradicted evidence and that it

made ultimate findings contrary to its evidentiary findings and other evidence in the record not considered by it.

In reviewing the Tax Court's findings as to the reality of the partnership, this Court is fully authorized to consider all the evidentiary facts and circumstances, and to reverse the Tax Court where they do not support or are inconsistent with the ultimate findings.

Limitations upon the scope of review of such issues by the Courts of Appeals, imposed by a series of Supreme Court decisions culminating in *Dobson v. Commissioner,* 321 U. S. 231, 88 L.Ed. 691 (1944), have been removed by 1948 legislation. Section 1141 (a), Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948 (Public Law 773, 80th Cong., 2nd Sess.), 62 Stat. 646, provides that the Courts of Appeals have jurisdiction to review the decisions of the Tax Court "in the same manner and to the same extent as decisions of the District Courts in civil actions tried without a jury." This reads into the Internal Revenue Code the provisions of Section 52 (a) of the Federal Rules of Civil Procedure.

> *Grace Bros. v. Commissioner,* 173 F. (2d) 170 (C.A. 9, 1949);
>
> *Estate of Sullivan v. Commissioner,* 175 F. (2d) 657 (C.A. 9, 1949).

In the application of rule 52 (a), two basic principles are established by numerous decisions:

1. This Court may review both the facts as found by the trial Court and the evidence upon which those

facts are based. If the findings of fact are not supported by substantial evidence they are clearly erroneous within the meaning of rule 52 (a), and this Court is not bound by those findings.

2. This Court is never bound by the inferences and conclusions drawn by the trial Court from its findings of fact, but is always free to draw its own inferences and conclusions from the findings and the evidence.

These two basic principles are accepted and applied by this Court in *Estate of Gillette v. Commissioner,* 182 F. (2d) 1010, 1013-1014 (C.A. 9, 1950).

In the present case the evidentiary facts are not in conflict or dispute. This Court is not asked to determine the credibility of witnesses or to resolve a conflict in the evidence. The issue before this Court is whether petitioners and their children truly intended to enter into a partnership relationship. The resolution of this issue does not require reliance upon the Tax Court's expertness in tax matters.

In *Estate of Gillette v. Commissioner, supra,* a case not involving a technical tax question, the Court said:

> "It is commonly stated, and properly so, that due respect should be given to the Tax Court's expertness in tax matters. While in most circumstances such respect would weigh heavily, we are not impressed by it here where the ultimate inference of fact must be as to what the decedent contemplated as the driving reason for his actions regarding his property. In this duty, which does not bring technical tax questions into play, it is in no way derogatory to the Tax Court to say that United States Courts of Appeals are

> as well equipped to draw inferences as is the Tax Court and for that reason the Tax Court decision calls for little more weight than its logic suggests."

There being no conflict in evidence, and there being no technical questions upon which the expert judgment of the Tax Court might be determinative, this Court has full freedom to review the issues presented, and the findings of the Tax Court.

Much of the uncontradicted evidence considered material by the petitioners was disregarded in the Tax Court's findings and opinion, but the principal error made by the Tax Court was in failing to give effect to many of its own findings of fact. It has drawn inferences and reached conclusions that are unsupported by the evidence, and in some instances are inconsistent with its own findings of fact.

The action of the Tax Court can thus be characterized by Mr. Justice Reed's statement in his dissenting opinion in *Lusthaus v. Commissioner of Internal Revenue,* supra, where he stated:

> "The suggestions seems to be that an inference of intention entirely contrary to all the primary facts may be deduced at will and without challenge by the tax court." (327 U. S. 302, 90 L. Ed. 687.)

This court is empowered in this case to review the evidence adduced at the hearing to draw the proper inferences or conclusions therefrom and to determine the ultimate fact that the three Harknesses and Harriet Colgate intended to join together in conducting

the business of United Packing Co. as bona fide partners in 1943 and thus their partnership is valid for tax purposes in that year.

II.

THE TAX COURT ERRED IN THAT ITS DECISION IS CONTRARY TO THE APPLICABLE DECISIONS OF THE SUPREME COURT OF THE UNITED STATES.

A. The Tax Court Failed to Apply the "Reality Test" as to the Existence of a Family Partnership Set Forth in Commissioner v. Culbertson.

The Supreme Court, in *Culbertson v. Commissioner,* supra, established that the reality of a partnership for tax purposes should be determined on whether or not the parties truly intended to join together in conducting a business. It rejected as invalid tests which do not take into account the intent of the parties. In this connection the Supreme Court said:

> "But the Tax Court did not view the question as one concerning the bona fide intent of the parties to join together as partners. Not once in its opinion is there even an oblique reference to any lack of intent on the part of respondent and his sons to combine their capital and services 'for the purpose of carrying on the business.' Instead, the court, focusing entirely upon concepts of 'vital services' and 'original capital,' simply decided that the alleged partners had not satisfied those tests when the facts were compared with those in the Tower Case. The Court's opinion is replete with such statements as '*we discern nothing constituting what we think is a requisite contribution to a real partnership,*' '*we find no son adding*

'vital additional service' which would take the place of capital contributed because of formation of a partnership' and *'the sons made no capital contribution within the sense of the Tower Case'."* (Emphasis Supplied). 337 U. S. 743-745, 93 L.Ed. 1666).

In this case, as in the *Culbertson* case, the Tax Court's opinion is replete with statements concerning the absence of original capital contributions and vital services, and although it is couched in "Culbertson" language, it reveals that the Tax Court decided the case solely by an application of the vital services—original capital test. That the Tax Court relied solely on these invalid tests is evidenced by the following excerpts from its opinion:

1. ". . . it was not contemplated by any of the parties that the Harkness children would contribute substantial capital or vital services to the conduct of the business in 1943 or play any active part in its management" (R. 275).

2. "The circumstances existing in the fall of 1942 also make it obvious that no vital service or contributions of original capital could have been expected from the Harkness children in 1943" (R. 276).

3. "In keeping with economic status, neither Harkness child made any substantial contribution of new capital to United Packing Co. when the partnership was formed in 1943" (R. 276).

". . ., we must conclude that neither Harkness, Jr., nor Harriet Colgate contributed any substantial capital not already available to the com-

pany within the meaning of *Lusthaus v. Commissioner*, 327 U. S. 293" (R. 277).

4. "Young Harkness and Harriet Colgate rendered no vital services, nor did they participate in the management of the business during that year" (R. 278).

The Tax Court in an attempt to bring its decision within the letter of the Supreme Court's admonition found, with respect to intent, that "it was not *contemplated by any of the parties* that the Harkness children would contribute substantial capital or vital services" (R. 275).

Having found that it was intended by the parties that the children would not contribute substantial capital, the Tax Court then concluded that the parties "had no present intent . . . to operate as a genuine partnership" (R. 280).

It seems to us obvious that the Tax Court in fact made no actual finding as to intent but declared the partnership invalid on the basis of the tests rejected by the Supreme Court.

B. The Tax Court Erred in Not Considering, in Making Its Ultimate Finding With Reference to Intent, the Evidence Relating to the Ownership of the Capital Contributed by the Children to the Partnership.

The Supreme Court in the *Culbertson* case, supra, did not remand the proceeding to the Tax Court for the purpose of having it find whether it had been intended or contemplated by the parties that the Culbertson children would contribute substantial capital

or vital services. Rather, the Supreme Court ordered the Tax Court to find whether, during the years in question, the children rendered services or contributed capital of which they were the true owners, and to determine from such findings whether the parties had the requisite intent to join together in a genuine partnership. In remanding that case the Supreme Court said:

> "The cause must therefore be remanded to the Tax Court for a decision as to which, if any, of respondent's sons were partners with him in the operation of the ranch during 1940 and 1941. As to which of them, in other words, was there a bona fide intent that they be partners in the conduct of the cattle business, either because of services to be performed during those years, or because of *contributions of capital of which they were the true owners,* as we have defined that term in the Clifford, Horst and Tower cases?" (Emphasis supplied.) (337 U. S. 748, 93 L.Ed. 1668.)

It will be noted that the Supreme Court did not require the Tax Court to find on intent on the basis of original capital, but it merely required a determination as to whether the children were the true owners of the capital contributed to the partnership.

In the instant case, the evidentiary findings of the Tax Court as to the true ownership of the capital contributed by the children are as follows:

> "On January 1, 1943, petitioners transferred to United Packing Co., a partnership, most of the assets and some of the liabilities of United

Packing Co., sole proprietorship, existing on December 31, 1942, resulting in a net worth of $138,241.61 for the partnership on that date. Harkness, Jr., and Harriet Colgate each bought a one-fourth interest in the partnership for $34,560.41, equivalent to one-fourth of its net worth. To pay Harkness, Sr., for his share in the partnership the son used $1,392.05 of the credit he had earned as compensation for prior services rendered the sole proprietorship and on January 2, 1943, signed a promissory note for the remaining $33,168.35 with interest at four per cent per annum. Harriet Colgate purchased her partnership interest from her father with a promissory note dated January 2, 1943, for $34,560.40 plus four per cent interest per annum. William Colgate joined her on the note as co-maker . . ."[7] (R. 257-258).

The above described transaction is formally evidenced by the following provision contained in the partnership agreement:

> ". . . first and second parties herein, do by these presents, sell, convey and set over, an undivided one-fourth partnership interest in and to all of the partnership property of the United Packing Co. to each of the third and fourth parties, namely, Floyd James Harkness, Jr., and Harriet Harkness Colgate, and from this date on each of the said co-partners above named, shall be and become the owners of an undivided one-fourth interest of all of the property of the said co-partner-

[7]The finding deleted reads: "No collateral was required on either note". We will elsewhere show that this finding was entirely erroneous.

> ship doing business under the firm name and style of United Packing Co. and that the real and personal property which shall compose the capital of the said co-partnership and belong to the newly organized co-partnership is described in a Schedule marked Exhibit "A" and attached hereto and made a part of this agreement as if herein fully set out, and that there shall also belong to said co-partnership any and all other assets which now belong to said co-partnership and are not herein described as well as any and all other assets which may hereafter belong to said co-partnership; that all thereof shall belong equally to all of the partners herein named and in consideration of said first party conveying all of said real and personal property to said co-partnership being conducted under the firm name and style of the United Packing Co., and which is agreed to be of the net value of $138,241.61, that the said third and fourth party shall each execute in favor of first party a promissory note in the sum of $34,560.40, payable in the manner as therein set forth to first party, and which sum shall be the purchase price for their undivided one-fourth interest in and to all of the assets of said co-partnership" (R. 261-262).

There is no statement either in the findings or in the opinion that expressly or impliedly attacks the good faith of the transaction described in the above quoted findings. The Tax Court merely disregarded this unimpeachable transaction in arriving at its decision. It must, therefore, be conceded that the Harkness children made "contributions of capital of which they were the true owners" to the partnership.

The Tax Court, contrary to the mandate of the Supreme Court, did not consider this fact in this case. The correct approach to the problem is illustrated by the Tax Court's opinion in its second decision in the *Culbertson* case. There the Tax Court said:

> "Under the facts which we have found, was there a partnership within the purview of the applicable statutes and decisions? After discussion of the principles involved, the Supreme Court held that the case be remanded to us for decision as to which, if any, of the petitioner's sons 'were partners with him in the operation of the ranch during 1940 and 1941. As to which of them, in other words, was there a bona fide intent that they be partners in the conduct of the cattle business, either because of services to be performed during those years, or because of contributions of capital of which they were the true owners' as that term is defined in *Helvering v. Clifford* 309 U.S. 331; *Helvering v. Horst,* 311 U.S. 112, and *Commissioner v. Tower,* 327 U.S. 280. In so deciding, we have not placed emphasis upon any one or more questions or principles involved, but have considered all of the evidence in the light of the opinion of the Supreme Court in this cause and those opinions to which it refers."
>
> *Culbertson v. Commissioner,* 9 T.C.M. 647, 652 (1950).

After having correctly stated the law, the Tax Court found that the Culbertson children were not, under the facts disclosed by the record, the true owners of the capital contributed, and on the basis of

this finding, determined that the parties had not truly intended to join together in a partnership business. The record in the instant case does not permit the Tax Court to make a similar finding and for this reason the Tax Court has attempted to rob this good faith transaction of its reality by making certain erroneous findings and by failing to consider other evidence in the record.

In the portions of this brief that follow, we will discuss the erroneous findings of the Tax Court and its error in not making findings with respect to other evidence in the record which establishes the reality of the transaction.

C. The Tax Court Erred in Not Giving Any Consideration to the Good Faith of the Parties and in Substituting Its Judgment for That of the Petitioners in Appraising the Value of the Consideration Given by the Children for Their Interest in the Partnership.

The Supreme Court, in the *Culbertson* case, told the Tax Court to give effect to the good faith of the parties and not to attempt to substitute its judgment for that of the parties in appraising the value of the services or capital contributed to the partnership, and in so doing said:

> "Unquestionably a court's determination that the services contributed by a partner are not 'vital' and that he has not participated in 'management and control of the business' or contributed 'original capital' has the effect of placing a heavy burden on the taxpayer to show the bona fide intent of the parties to join together as partners. But such a determination is not conclusive, and that is the vice in the 'tests' adopted by the Tax Court.

It assumes that there is no room for an honest difference of opinion as to whether the services or capital furnished by the alleged partner are of sufficient importance to justify his inclusion in the partnership. If, upon a consideration of all the facts, it is found that the partners joined together in good faith to conduct a business, having agreed that the services or capital to be contributed presently by each is of such value to the partnership that the contributor should participate in the distribution of profits, that is sufficient. The Tower Case did not purport to authorize the Tax Court to substitute its judgment for that of the parties; it simply furnished some guides to the determination of their true intent."

(337 U.S. 744-745, 93 L.Ed. 1666, 1667.)

It is clear that in this case the Tax Court did not heed the admonition of the Supreme Court contained in the above quotation.

The evidentiary findings of the Tax Court clearly showed that the petitioners were motivated in forming the partnership by legitimate reasons and not by a desire to minimize taxes. In this connection, the findings of the Tax Court show the following:

"In the fall of 1942 Harkness, Sr., became convinced that it would be advantageous to convert the operation of his fruit packing and shipping business from a sole proprietorship to a partnership composed of his wife, himself and his two children in the coming year. *Many reasons dictated that decision.* Primarily he desired to obtain the services of his son and son-in-law in the business. He felt that as a result of their college

education and the practical experience they had gained pursuing agricultural employment in the Valley that they would make skilled, competent supervisors capable of overseeing the widespread operations of the company. Secondly, from his experience in the fruit and vegetable packing industry, Harkness believed that it was essential to increase the capital investment in the company by allowing annual profits to remain in the business. This was necessary not only to permit payment of extensive operating expenses, to allow for expansion of company facilities and equipment and to develop new business, but also to meet the exigencies of bad crop years when the company's income declined drastically. Furthermore, in 1942 fruit packers were anticipating a decline in profits due to labor shortages, low transportation priorities for their produce, and the probability that prices would tumble as in World War I. These circumstances only increased the need for increasing the capital reserve of United Packing Co. Yet it had been Harkness' experience in past years that to hold qualified supervisory personnel it was necessary to pay them large bonuses or percentages of profits which they invariably withdrew from the business and often used to set themselves up in competition with him, thus draining the company's capital. He felt the only way to retain profits in the company was to bring into the business persons who felt as he did. Through long discussions with Harkness, Jr., and William Colgate petitioner knew that they agreed with him that only a reasonable amount of the profits should be withdrawn from United Packing Co. and the rest of the net income should be allowed to accumulate in the business.

> While Harkness, Sr., was well aware that neither Floyd, Jr., nor William Colgate would be available to serve United Packing Co. for the duration of the war and he would be the only active partner in the meantime, yet he desired them to acquire an interest in the company at this time to guarantee their future help in running the business after their release from the Army. * * *
>
> * * * *While Harkness, Sr., consulted a lawyer concerning the feasibility of converting his business into a partnership and was thus aware of the tax saving possibilities inherent therein, yet this fact was only a secondary consideration with him, and he would have entered into this arrangement regardless thereof"* (R. 253-256) (Emphasis supplied).

The Tax Court found, as the foregoing findings indicate, that the parties were in good faith and animated by a legitimate purpose when they determined to form the partnership. The Tax Court, however, did not consider this factor in making its decision. This must be held to be error. In *Greenberger v. Commissioner,* 177 F. (2d) 990, 994 (C.A. 7, 1949), the Court of Appeals said:

> "The Court in the Culbertson case left no doubt that the predominant factor is the good faith and legitimate purpose of the parties in forming a partnership."

The record and the findings also show that the Petitioners received good and valuable consideration for

the property transferred to the partnership and that the contributions made by their children and their son-in-law to the partnership were adequate. The Tax Court, however, has substituted its judgment for that of the Petitioners in appraising these values. In so doing the Tax Court has attempted to minimize the consideration given by the children by finding, contrary to the record, that the notes executed by them in payment for their interest in the partnership were not secured by collateral (R. 258).

That the action of the Tax Court in this regard is unwarranted is disclosed by the following facts in evidence:

1. The notes, unconditional promises to pay, were executed by the Petitioners' children and son-in-law. The Petitioners expected these notes to be paid regardless of whether or not income or profits were derived from the operation of the partnership (R. 190).

2. The son and the son-in-law were regarded by the Petitioners as being capable of rendering valuable services and were for this reason worthy of credit. In the judgment of the Tax Court the possession of assets rather than the ability to earn determines whether credit should be extended.

3. The notes show, on their face, that they were secured by the interests of the children in the partnership. Each note contains the following language: "This note is secured by my one-fourth interest in the United Packing Co. of Fresno, California" (R. 119; 121).

These notes were likewise secured by the income to be derived from the partnership earnings. The partnership agreement states:

> "* * * any profits which third and fourth parties are entitled to receive shall be paid to first party and applied by him first, to any payment which first party may have advanced to third and fourth parties, together with interest thereon, and the balance thereof, if any, shall be applied by first party in the payment of the promissory notes which the said third and fourth parties have executed in favor of first party for the purchase price of their share in said co-partnership business" (R. 263).

The Petitioners were, therefore, secured not only by the ability of their son and son-in-law to earn but also by the value of the childrens' interest in the assets and income of the partnership. We submit, therefore, that the children were given nothing but credit and that their contributions should be deemed original capital.

4. The partnership agreement states:

> "* * * each partner shall likewise share equally in any losses which the said partnership may sustain and that each partner shall in the event it becomes necessary to furnish additional funds by reason of any losses which the said partnership may sustain, then each partner shall furnish and pay into the said business his equal share which may be necessary in order to continue on with the said co-partnership business" (R. 269).

It is clear that that transaction and commitment evidenced by the partnership agreement was bona fide

and it must, therefore, be conceded that the Petitioners received additional valid consideration through their childrens' agreement to share the losses and to furnish additional capital when necessary. An agreement to contribute capital and assume the risks and liabilities attached to the partnership relationship is in law valid and adequate consideration. (See 47 C.J., *Partnerships,* Sec. 46, p. 654.)

5. The present commitment of the son and son-in-law to render services in the future was appraised by Petitioners as of great value to them, and we are told in the concurring opinion of Mr. Justice Burton in the *Culbertson* case that:

> "A present commitment to render future services to a partnership is in itself a material consideration to be weighed with all other material considerations for the purposes of taxation as well as for other partnership purposes." (337 U.S. 749, 93 L.Ed. 1669).

In this connection it should be observed that a present commitment to render services in the future has been held valid consideration for the transfer of property. (37 C.J.S., *Fraudulent Conveyances,* Sec. 148, p. 969.)

The evidence in the record not considered by the Tax Court shows that the commitment to render services in the future by Petitioners' son and son-in-law was fully performed (R. 129, 217-222; 128, 229-230, 240-243). It is clear, therefore, that as to this part of the agreement there was no failure of consideration and that Petitioners received what they bargained for.

The evidence also discloses that the agreement to conserve profits and to increase the capital of the partnership was likewise performed by all the parties (Exhibit "6-F," R. 55-68).

Finally, it should not be overlooked that in the view of the Tax Court in other cases, a promissory note paid out of the profits of a partnership is a valid capital contribution. In the case of *Tindall v. Commissioner,* 14 T.C., No. 125 (1950), the Commissioner, in assessing a deficiency against Tindall contended that a valid partnership existed between him and his son. Tindall, on the other hand, contended that no valid partnership existed. There, Tindall had conveyed an interest in his business to his son and took in return his son's promissory note which was to be paid out of the son's share in the profits. The Tax Court found against existence of a partnership solely on the ground that the son was a minor when the transaction was entered into. In so ruling, the Tax Court said:

> "The cases cited by respondent in support of his argument that the son made a valid capital contribution are distinguishable. In *Atkins v. United States* (Dist. Ct., W. Dist. La.), 86 Fed. Supp. 342, the son, a minor, had his disabilities removed prior to signing the partnership agreement with his father. Moreover, though he borrowed $20,000.00 of the cash that he contributed from his father, giving a note therefor, he later repaid the note out of profits, thus making an actual contribution to the capital of the partnership. Similarly, in *Green v. Arnold* (Dist. Ct., N. Dist. Tex.), 87 Fed. Supp. 255, the two minors who were held to be partners had given notes as

> their capital contribution, which they later repaid out of profits. Here, as we have pointed out, the son's only contribution was a voidable note, which was never ratified, but, instead, was specifically avoided by him. The general rule is that an infant's disaffirmance of his contract nullifies it and renders it void ab initio. 43 C.J.S. 176. It is therefore our holding that the son made no capital contribution to the alleged partnership."

It is, therefore, submitted that the facts and circumstances above related and discussed show that the bargain made by Petitioners was not so unreasonable and so contrary to good business judgment as to leave no room for an honest difference of opinion as to its value to them. This being so, it is error for the Tax Court to override the considerations that impelled Petitioners to enter into a partnership arrangement with their children. The Tax Court also erred in giving no effect whatsoever to the good faith of the parties in making and performing their agreement.

III.

THE TAX COURT ERRED IN MAKING FINDINGS AND CONCLUSIONS THAT ARE CONTRARY TO THE RECORD AND IN FAILING TO CONSIDER AND MAKE FINDINGS ON EVIDENCE SHOWING THE CONDUCT OF THE PARTIES IN YEARS SUBSEQUENT TO THE TAX YEAR IN QUESTION.

A. It Was Error for the Tax Court to Disregard Undisputed and Convincing Evidence Disclosing the Bona Fide Performance of the Partnership Agreement.

In demonstrating the errors contained in the findings and conclusions of the Tax Court it will be neces-

sary for us to discuss evidence in the record not considered by the Tax Court, and on which it made no findings. This evidence was admitted without objection on the part of Respondent and was relevant and material as to the issues presented to the Tax Court.

The Tax Court in the instant case has by a process of segmentation isolated the events which took place in the year 1943, and thereby has limited itself to a consideration of only these occurrences. We find no support for this either in the law or in the record. The agreement of the parties did not set a term for the expiration of the partnership, and the partnership was by its terms of indefinite duration and has operated for several years.

The case of *Grayson v. Deal,* 85 F. Supp. 431 (N.D., Ala., S.D., 1949), shows that evidence of events which occurred subsequent to the tax years in question may be considered in determining the reality of a partnership arrangement. In that case the Commissioner refused to recognize as valid a family partnership and assessed deficiencies against the plaintiff for the years 1943, 1944 and 1945. These deficiencies were paid subsequent to the tax years in question. After these deficiencies had been paid, the plaintiff's wife and children sought and obtained refunds of income taxes paid by them. The proceeds of the refunds were turned over to plaintiff by his family and he used them to pay the deficiencies assessed against him. The District Court considered this evidence and found that the partnership was invalid and in so doing said:

> "When the plaintiff was called upon to pay the deficiency assessments here involved, the evidence shows that his wife and children promptly and willingly turned over their refund claims totaling some $53,000, and the plaintiff applied these sums to the payment of his own assessments. These refund claims represented the income taxes that the other alleged partners had paid to the government because of monies earned by the business. Of course, plaintiff says that he expects to pay them back when the case is settled. However, he received these large sums from them without even going to the inconvenience of giving them any form of evidence of indebtedness. This is quite in contrast to the meticulous care and great particularity practiced in preparing and signing the various long, complicated, solemn agreements at the time the alleged partnership was formed. When this $53,000 of the alleged monies of his wife and children was needed by Mr. Grayson, it was as readily available as any of his own funds."
>
> (85 F. Supp. 435.)

We submit that if evidence of events subsequent to the tax years in question may be used to prove the mala fides of a transaction such evidence may also be employed to show the bona fides of a transaction.

We are also supported in our contention by the fact that a partnership agreement does not become fully executed until the partnership relationship ends. In other words, the partners continue to perform the provisions of the agreement until the partnership is dissolved, and it is reasonable to conclude that evidence respecting this performance will shed light on

the bona fides of the transaction. This appears to be the view taken by the Supreme Court in *Commissioner v. Tower,* supra. There the Supreme Court said:

> "When the existence of an alleged partnership arrangement is challenged by outsiders, the question arises whether the partners really and truly intended to join together for the purpose of carrying on business and sharing in the profits or losses or both. And their intention in this respect is a question of fact, to be determined from testimony disclosed by their 'agreement, considered as a whole, *and by their conduct in execution of its provisions'.*" (citing cases) (Emphasis supplied.)
>
> * * * * * * *
>
> "The issue is who earned the income and that issue depends on whether this husband and wife really intended to carry on business as a partnership. *Those issues can not be decided simply by looking at a single step in a complicated transaction.*" (Emphasis supplied.)
>
> (327 U.S. 286-287; 289-290, 90 L.Ed. 675; 677.)

The foregoing expressions of the Supreme Court indicate that the conduct of the parties subsequent to the tax years in question is relevant. Therefore, the Tax Court erred through its failure to consider this evidence, and its action in basing its findings on only part of the record.

> "It is suggested that this Court should accept the findings of the Board; that contradictions, inconsistencies, and erroneous inferences are immune from criticism or attack by Section 10(e) of the Act, 49 Stat. 453, 29 U.S.C.A. §160(e), which provides that 'the findings of the Board as to the facts, if supported by evidence, shall be

conclusive' *But the courts have not construed this language as compelling the acceptance of findings arrived at by accepting part of the evidence and totally disregarding other convincing evidence.*" (Emphasis supplied.)

N.L.R.B. v. Union Pacific Stages, 99 F. 2d 153, 177 (C.C.A. 9, 1938.)

B. The Tax Court Erred in Finding That During the Year 1943 the Business of the Partnership Was Still Completely Under the Control of Harkness, Sr. This Finding Is Contrary to the Record and Fails to Give Effect to the Intent and Good Faith of the Parties.

The Tax Court seeks to support its decision herein by finding that:

"During the year 1943, there was no change in the operation of United Packing Co. over prior years. The business was still completely under the control of Harkness, Sr." (R. 270).

In its opinion, the Tax Court maintains that evidence in support of this finding is to be found in the partnership agreement, the supplementary agreement of January 4, 1943, the actual conduct of the partnership business during 1943, and in the testimony of Harkness, Sr. In this connection the Tax Court said:

1. "Turning to the partnership agreement, it also refutes an intent by the signatories to join together in the present conduct of the affairs of United Packing Co., but rather shows an intent that Harkness, Sr., continue to control the conduct of the business as in prior years, when he was sole proprietor. The parties therein agreed that neither Harriet, young Harkness nor Molly

Harkness would devote any time to carrying on the business unless thereafter agreed upon, but that Harkness, Sr., would be general manager thereof in full charge of all business operations which he might conduct as he chose. Harkness was given full charge of the books of accounts of the partnership and of the collection and expenditures of money taken in. His consent was necessary to bind the partnership in any business transaction and to lower or raise partnership capital. His participation was necessary in the adjustment of any misunderstanding between the partners as to the conduct of the business and in the determination of the proper allocation of profits and losses among the partners" (R. 277, 278).

2. "The supplementary agreement of January 4, 1943, also contradicts any intent on the part of the alleged partners to join together their services in the conduct of United Packing Co. in 1943. By its provisions Harkness, Sr., alone was to receive compensation for services because he was to be the only active partner in the business for the duration of the war" (R. 278).

3. "Finally, the actual conduct of the business of United Packing Co. in 1943 makes it clear that the parties intended for Harkness, Sr. to operate it as a sole proprietor for the duration of the war. Young Harkness and Harriet Colgate rendered no vital services, nor did they participate in the management of the business during that year. Harriet was absent from Fresno the entire time. While by chance young Floyd was stationed in California during almost all of 1943 and frequently visited the company's plant on weekends to talk over business conditions with

his father, yet such visits hardly bespeak an active role in the conduct of the company, but rather a continuing interest therein by a prospective participant. The evidence reveals only one transaction, the purchase of River Ranch, where the approval of his children was sought by Harkness, Sr." (R. 278, 279).

4. "Harkness, Sr., frankly admitted in his testimony that the conduct of the company's business was not altered in 1943, but remained essentially the same as in 1942, when he operated United Packing Co. as a sole proprietor" (R. 179).

The evidence discussed by the Tax Court does not support its findings. Support, if any, for these findings is to be found only in the erroneous inferences drawn from this evidence by the Tax Court.

The assertion that the business was still under the complete control of Harkness, Sr., during 1943, is contradicted by other evidentiary findings made by the Tax Court. We refer to the following:

1. "On December 31, 1942, 'Articles of Partnership', providing the detailed terms of the proposed partnership, were drafted and met the approval of all but Harriet Colgate, *who refused to sign until provisions as to control of the business* and as to purchase of a deceased partner's share were modified" (Emphasis supplied) (R. 257).

2. "During January, 1943, Harkness, Sr., discussed with the Colgates the modifications sought by Harriet Colgate in the partnership agreement drafted on December 31, 1942. *Harriet withdrew*

her objections when the original draft was altered to meet her demands (Emphasis supplied) (R. 259).

The testimony of Harriet Colgate underlying the above quoted findings also contradicts the assertion that Harkness, Sr., completely controlled the business. This testimony is as follows:

"Q. What did you do? Did you convey those objections to your family?

A. Yes, I did.

Q. Will you please explain to the Court just what you conveyed to your family and why you didn't sign the document?

A. Well, there were several stipulations in it that I didn't agree to, and as my husband had signed the note with me, which made him as liable for this amount we borrowed, he and I discussed it, and we just didn't agree to them.

Q. Can you recall what you didn't agree to generally, not in detail, but generally so the Court may have that picture?

A. That my mother and father, Molly A. and Floyd Harkness, *had too much power,* and in case of death there were several stipulations that we didn't agree to.

Q. You wrote that to your family?

A. Yes, we did.

Q. Subsequently was a new document sent to you or did your father and mother bring you one, or what occurred?

A. I believe my mother and father came shortly after that, and we had a long discussion about it. In March, after lengthy correspondence about it, the document was sent in March which we did agree to" (Emphasis supplied) (R. 200).

It is apparent from the foregoing that Harriet Colgate demanded at least that Harkness, Sr., have less than complete control of the business and that this demand was met. The Tax Court, however, assumed that the provisions of the agreement were without force and effect. This assumption results from the Tax Court's refusal to give effect to the good faith of the parties and from its refusal to give effect to the intent of the parties. This clearly indicates, as we have said before, that the Tax Court, contrary to the mandate of the *Culbertson* case, found itself free to disregard the intent of the parties as evidenced by their agreement, once it found to its satisfaction that the children had contributed neither original capital nor vital services.

The Tax Court seized upon the provision of the agreement giving certain enumerated powers to Harkness, Sr., to bolster its claim that Harkness, Sr., exercised complete control of the business. This, of course, is based on the erroneous premise, that Harkness, Sr., exercised the powers given him by the agreement, not as a partner and as an agent for the absent members, but as a sole proprietor, and in complete disregard of the partnership relationship. This conclusion likewise results from the Tax Court's failure to give effect to the intent and good faith of the parties, including Harkness, Sr. Although, as we have said before, the Tax Court failed to give effect to the good faith of the parties, it did not discredit their agreement as a sham or a device to avoid taxes. This being so the partnership agreement must be read in the

light of the intent of the parties, and if it is so read, the binding legal effect of its provisions must be considered in reviewing the findings of the Tax Court.

In considering whether or not complete control was retained by Harkness, Sr., over the assets, business and profits of the partnership, it is well first to inquire into the extent of his powers and control over the same property prior to the formation of the partnership. It is conceded that all the property of the Petitioners, including that transferred to the partnership, was community property. Under the community property laws of the State of California, the husband's powers of management and control are exclusive and absolute. *Section 172 of the Civil Code of the State of California,* expressly confers such powers upon the husband.

> "The husband has the management and control of the community personal property, *with like absolute power of disposition,* other than testamentary, as he has of his separate estate; provided, however, that he cannot make a gift of such community personal property, or dispose of the same without a valuable consideration, or sell, convey, or encumber the furniture, furnishings, or fittings of the home, or the clothing or wearing apparel of the wife or minor children that is community, without the written consent of the wife." (Emphasis supplied.)

Section 172a gives the husband the same power of management over the community real property.

Indeed, so exclusive and extensive are the husband's powers of management and control, that even

his abandonment of the wife, or the fact that he has disappeared gives her no special power over the community property (*Chance v. Kobested,* 66 Cal. App. 434, 226 P. 632 (1924)). As can be seen from Sections 172 and 172a of the Civil Code, the only limitation placed over the husband's powers of management and disposition of the community property is that he cannot make a gift of it or dispose of it without valuable consideration.

The most cursory examination of the partnership agreement and the supplements thereto make it evident that the unfettered command and control which Harkness, Sr., formerly had over the properties conveyed to the partnership have been substantially curtailed and diminished. Prior to the formation of the partnership his right to bind the property was unlimited. The partnership agreement, on the other hand, requires that the general manager and one other partner act together to bind the business. The partnership agreement provides:

> "It is understood and agreed that the said first party as general manager, and anyone of the other co-partners acting together shall have the right to bind the said co-partnership in such manner or form as they may deem necessary in order to carry on the business of the said co-partnership, and that no other co-partner shall have the right to in any manner bind the said co-partnership, * * *" (R. 263-264).

The power conferred by the original agreement on Harkness, Sr., to bind the partnership was further

limited by the supplement executed as of January 16, 1945 (R. 37-41, Exhibit 2-B). This supplement provides in part as follows:

> "* * * it shall now become necessary that first party and any two of the co-partners acting together with the said general manager shall have the right to so bind the said co-partnership" (R. 39).

The powers of Harkness, Sr., were also diminished in other respects. Prior to the formation of the partnership he could, at his pleasure, increase or reduce the working capital of the business, but upon the formation of the partnership this power ceased to exist. The partnership agreement provides as follows:

> "It is understood and agreed by and between the parties hereto that upon the consent of the managing partner and two of the remaining partners that the capital of the partnership may be increased to such sum as may be determined by them, and that thereafter each of the partners shall contribute their respective share of the capital increase. In the event the managing partner and two of the other partners desire to reduce the capital of the partnership or withdraw profits, then such determination shall become binding upon all the partners hereto" (R. 265).

Before the formation of the partnership, Harkness, Sr., determined at will the salaries to be paid to those rendering services to the business, except, perhaps in those instances where the employees had superior bargaining power. Under the partnership agreement, however, the salaries to be paid to the

partners rendering services to the partnership cannot be fixed by Harkness, Sr., alone, but are to be determined by agreement between any three of the copartners. In this respect, the partnership agreement provides:

> ". . . and at that time it shall be agreed upon by and between any three of said partners as to what the compensation shall be for the services which third or fourth partner may contribute towards the carrying on of said co-partnership business" (R. 264).

As manager of the community, and when the business was being conducted as a sole proprietorship, Harkness, Sr., had no duty to account or give information in connection with his conduct of the business. After the formation of the partnership he was compelled, under the express terms of the agreement, to account and to give information to the other partners with respect to the conduct of the business (R. 265). The control of Harkness, Sr., was also curtailed by the provisions of the *California Civil Code* applicable to the partnership relation. Before the formation of the partnership the Petitioners were the sole owners of the property involved. Thereafter, by operation of law, they were co-owners thereof with their children, and their right to possess it, theretofore unlimited, could only be exercised for partnership purposes (California Civil Code, Sec. 2419).

The agreement provides in the following terms that Harkness, Sr., shall be general manager of the copartnership:

"It is understood and agreed by and between the said co-partners that said first party shall be, and is from this date on made the general manager of said co-partnership and that he shall be in full charge of all business operations of said co-partnership and that he shall have the full right to conduct the business of said co-partnership in such manner as he may desire, including the selling of any and all of the partnership assets and the purchasing of such other property as he may desire in the name of said co-partnership together with the right to borrow such money as he may deem necessary to carry on said business and in consideration thereof it is understood and agreed that first party is to receive for his said services a certain percentage of the net profits of said business to be agreed upon between all of the partners herein from time to time as they may agree upon between themselves, * * *" (R. 262-263).

In addition, the agreement conferred upon Harkness, Sr., and one other partner the power to determine any question which might arise between the co-partners. This power was curtailed by an amendment contained in the supplement of January 16, 1945, where the following appears:

"* * * in the event of any misunderstanding between the co-partners concerning the matter of conducting and carrying on of said business, that the decision of the general manager and one other partner shall determine any question * * *" (R. 40).

We submit that the powers vested in Harkness, Sr., by the provisions of the agreement should not be considered in the nature of a grant of a privilege, but rather the assumption of a duty and a responsibility so onerous that the agreement provided that Harkness, Sr., should receive a salary in consideration of the performance by him of those duties, in addition to his profits.

It is also submitted that under the circumstances of the case it was most natural and reasonable that the powers of management should be vested in Harkness, Sr. When the partnership was first formed it was evident to everyone that both Harkness, Jr., and Colgate would be absent for an indefinite period, and this required the assumption of management powers by the most experienced and unquestionably the most capable member of the partnership.

Moreover, as the Board of Tax Appeals once observed:

> "A partnership not infrequently has a manager."
> (*George Bros. & Co. v. Commissioners,* 41 B.T.A. 287, 293 (1940).)

Decisions of the California Appellate Courts, as well as decisions of the Tax Court, are authority for the proposition that the fact that the power of management is conferred upon one of the partners does not negative the existence of the partnership. In the California case of *Lyon v. MacQuarrie,* 46 Cal. App. (2d) 119, 115 Pac. (2d) 549 (1941), the following is stated in support of this proposition:

"That there was no complete control of every part of the venture vested in each partner does not negative the existence of a partnership, for, by agreement, one partner may be given the duty of management of the partnership enterprise or any part of it. (*Thompson v. O. W. Childs Estate Co.,* 90 Cal. App. 552, 266 Pac. 293; *Associated Piping & Engineering Co., Ltd. v. Jones,* 17 Cal. App. (2d) 107, 61 Pac. (2d) 536.)"

In the case of *J. A. Riggs Tractor Co. v. Commissioner,* 6 T.C. 889 (1946), the Commissioner contended, among other things, that because of a certain management provision, the partnership there in question was not a partnership, but an association. The management provision in the *Riggs* case read, in part, as follows:

"* * * provided that in the event of a disagreement or difference in opinion between the partners *as to any matter of policy or any action to be taken or omitted in the conduct of the partnership business, the judgment of John A. Riggs, Sr.,* * * * *shall be controlling, and shall determine the policy to be adopted and the action to be taken or omitted.*" (Emphasis supplied.)

(6 T.C. 892.)

The Court will note that by its very generality the above quoted provision conferred upon Riggs, Sr., powers which were by far more extensive than those granted to Harkness, Sr. Notwithstanding this last mentioned fact, the Tax Court held that this was not incompatible with the existence of a true partnership, and in so doing stated the following:

"The fact that Riggs, Sr. was given a controlling vote in the event of a disagreement between the partners or a difference in opinion as to a policy to be adopted does not alter the case. *It is not uncommon for a partnership to have a managing partner.* Cf. George Bros. & Co., supra. *Certainly, that part of the partnership agreement giving Riggs, Sr. this veto power is not so rare a provision in partnership agreements as to require our holding that this enterprise was more than an ordinary partnership. It is not an uncommon feature in partnership agreements.* We are unable to discern any real distinction between the management and control of petitioner's business and the management and control of the business of ordinary partnerships. We are satisfied that the operations and business conduct of petitioner more closely resemble the operations of an ordinary partnership than the operations of a corporation." (Emphasis supplied.)

(6 T.C. 897, 898.)

The only conclusion to be drawn from the foregoing is that the former unfettered power and control which Harkness, Sr., once had, have been effective and substantially limited and diminished by the terms of the partnership agreement, and by the provisions of the California Civil Code applicable to the partnership relation. In addition, the foregoing also demonstrates that the powers of management vested in Harkness, Sr., have, under the facts of this case, a reasonable basis and are, under the authority of the decisions of the Tax Court and other Courts entirely consistent with, and do not negative the existence of a true partnership.

It is respectfully submitted in the light of the foregoing, that because of the terms of the parties' bona fide agreement Harkness, Sr., did not have the control of a sole proprietor of the business of United Packing Company in 1943.

The Tax Court next seeks to support its findings on erroneous and invalid inferences drawn from the provisions of the supplementary agreement of January 4, 1943. The Tax Court draws an inference of lack of intent from the fact that this agreement contemplated that for the duration of the war Harkness, Sr., was to be the sole active partner and was to be paid a salary commensurate to the responsibilities assumed by him. From the provisions of this instrument and from the further circumstance that Harkness, Sr., was the only partner that was active in 1943, the Tax Court draws the following additional erroneous inference:

> "* * * the income of United Packing Co. for 1943 was earned by the efforts of Harkness, Sr., and the capital contributed by both petitioners rather than from the services or capital contributions of the son and daughter" (R. 279-289).

These erroneous inferences overlook that the services performed by Harkness, Sr., were not performed by him as a sole proprietor but as an employee and agent of the partnership. These inferences likewise ignore that capital of which the children were "true owners" was being employed in the operations of the partnership. Lastly, these inferences also ignore that important services were rendered by Chris Sorenson, another employee of the partnership, during the year

in question, and that the partnership, not Harkness, Sr., paid this employee substantial compensation for his services. Exhibit 5-E, attached to the stipulation of facts (R. 53-54), shows that Sorenson received from the partnership for his services the sum of $53,283.39. In addition, Sorenson received as his share of the profits from the operation of the "River Ranch" by the partnership the sum of $60,309.92 (Exhibit 4-D, R. 52). In this connection it should be recalled that all the funds necessary for the purchase of the "River Ranch" were advanced by the partnership (R. 269-270).

In the case of *Greenberger v. Commissioner,* supra, the respondent sought to prevail on the basis of similar erroneous inferences drawn by the Tax Court from the evidence. In that case the petitioner had formed a family partnership with his wife and minor children. The children and the wife rendered no services, and the facts showed that the income of the partnership had been earned through the personal services of the petitioner and other employees of the partnership. The Tax Court held, therefore, that all the income of the partnership should be taxed to the Petitioner. The Court of Appeals for the Seventh Circuit reversed the Tax Court. The Court of Appeals determined that the partnership was bona fide and on the basis of this determination found that the income belonged to the partnership and not to the Petitioner. In this connection the Court of Appeals said:

> "Another contention closely tied in with the lack of capital as an income producing factor is

that petitioner by the rendition of personal service was responsible for production of the income. It is true the court in Tower stated, 327 U.S. at page 289, 66 S. Ct. at page 537, 'The issue is who earned the income,' but the court also stated, 'that issue depends on whether this husband and wife really intended to carry on business as a partnership.' *If the partnership in the instant case was bona fide, as we think it was, the income earned was that of the partnership and not that of petitioner.* While petitioner undoubtedly was the predominating force in the conduct and management of the business, the Commissioner overlooks the fact that the partnership paid him a salary of $45,000 per annum during each of the taxable years for his services thus rendered. In this connection, it is pertinent to note that only 24% of the partnership's income for 1943, and 37% for 1944, were attributable to commissions earned by petitioner. The remainder of the income was attributable to commissions earned by other employees, called sales engineers. *The Commissioner, in our view, erroneously treats these sales engineers as employees of petitioner rather than of the partnership.*" (Emphasis supplied.) (177 F. (2d) 994.)

The Tax Court attempts to find further support for its invalid finding in the fact that, so far as the record shows, the children were consulted only with reference to one transaction during the year 1943. This transaction involved the purchase of the "River Ranch." This fact does not aid the Tax Court. This transaction was the only transaction during the year 1943 which was not in the category of those that may

be classified as being within the ordinary course of the business of the partnership. This was an extraordinary transaction, which entailed among other things the advancing of funds for the purchase of Sorenson's interest. This demonstrates very clearly that when Harkness, Sr., sought and obtained the consent of his children before entering into the transaction, he realized that he was not a sole proprietor and that he was cognizant of his partnership obligations.

As a final point in support of its contentions, the Tax Court states that Harkness, Sr., admitted that the conduct of the business in 1943 remained essentially the same as in 1942, when he operated it as a sole proprietor (R. 279). In appraising the validity of this point we should refer to the testimony on which it is based. This testimony is as follows:

> "Q. Now, after the agreement of December 31, 1942, what change was made in the conduct of the business?
>
> A. No change could be made immediately. I had to continue along paying the high bonuses, high salaries, and putting in an extra lot of hours myself.
>
> Q. Continued just the same as it had prior to 1942, didn't it?
>
> A. No. We had a lot more troubles in '43 and '44 than we ever had in '42.
>
> Q. Well——
>
> A. The war was on, Mr. Mather.
>
> Q. The war was on in '41?
>
> A. December 8, 1941, we actually declared war, pretty near the end of the year.

Q. How did your business change in its operation after your agreement of December 31, 1942?

A. Let me——

Q. Just answer my question if you can.

A. How did the business operations change?

Q. Yes.

A. They didn't change.

Q. When was the first time they changed after your agreement of December 31, 1942?

A. Well, with the return of Mr. Colgate in October, 1944, that is the first time that one of the partners participated" (R. 152-153).

The above quoted portion of the record shows very general answers to very general questions propounded to the witness on cross examination by counsel for the Respondent, and their content demonstrates that by a change of operation the witness had in mind merely an actual participation in the conduct of the business by the other partners, and not other changes as to which there is abundant evidence. It is apparent also that this testimony has no bearing on the issues. We know of no case, and the decision of the Tax Court fails to mention any, which would require a *change* in the manner of operating a demonstrably successful business as a condition precedent to establishing the bona fides of a partnership formed to acquire and operate such a business.

We submit that all of the foregoing shows, as we have said before, that the findings and decision of the Tax Court result solely from its resort to the invalid original capital-vital services tests.

C. The Tax Court Erred in Concluding That Petitioners' Children Did Not Have Unhampered Enjoyment of Their Respective Shares of the Proceeds of the Business. This Conclusion Is Unreasonable and Contrary to the Record.

In *Commissioner v. Culbertson,* supra, the Supreme Court stated that if a participant in a partnership arrangement is free to, and does enjoy the income of the partnership, this fact gives a strong indication of the reality of the arrangement.

> "If the donee of property who then invests it in the family partnership exercises dominion and control over that property—and through that control influences the conduct of the partnership and the disposition of its income—he may well be a true partner. Whether he is free to, and does, enjoy the fruits of the partnership is strongly indicative of the reality of his participation in the enterprise." (337 U.S. 747; 93 L.ed. 1668.)

There is abundant evidence in the record to show that Petitioners' children were at all times free to enjoy their respective shares of the profits of the business. In the statement of the facts we have shown that Petitioners' daughter and her husband withdrew in the period 1943-47 the sum of $100,138.48 as and for salary and net profits from the business, and that Petitioners' son during the same period withdrew salary and profits in the sum of $121,484.51. It should be remembered that these withdrawals do not include sums used for the payment of taxes.

The Tax Court attempts to destroy the effectiveness of this evidence by disregarding the free enjoyment of profits by Petitioners' children in the years subse-

quent to 1943 and by seizing on the circumstance that the children had pledged the first profits to the payment of their notes. In this connection the Tax Court said:

> "Furthermore, the Harkness children had no unhampered enjoyment of their share of the profits, for net income accruing to them was first to be turned over to Harkness, Sr., and applied to any payments he may have advanced to them and the balance was then to be applied on the promissory notes executed in his favor" (R. 278).

This conclusion is unreasonable. It is premised on the absurd proposition that a debtor does not own or enjoy income if he employs it to pay his debts. This proposition is unreasonable even when judged in the abstract, but the extent of its absurdity is emphasized when considered in the light of the facts of this case. The evidence shows that Petitioners' children and their son-in-law greatly desired to become associated with the family business. The evidence also shows that in order to satisfy this desire they would have to pay for their interests in the business, because Harkness, Sr., did not believe in giving his children anything but the opportunity to make good (R. 148). Therefore, in the making of the bargain the children satisfied their desire and Harkness, Sr., his beliefs, by an agreement that the first profits of the partnership be used to pay the notes.

This makes it evident that when the children disposed of their right to receive part of their income in order to satisfy their desire to become co-partners in

the business, they enjoyed the fruits of their investment to the same extent as if they had not disposed of their right to collect it. As authority for this proposition we rely on the following taken from *Helvering v. Horst,* 311 U. S. 112, 116-117, 85 L. ed. 75, 78 (1940):

> "If the taxpayer procures payment directly to his creditors of the items of interest or earnings due him, see Old Colony Trust Co. v. Commissioner of Internal Revenue, 279 U. S. 716, 73 L. ed 918, 49 S Ct 499, supra; Bowers v. Kerbaugh Empire Co., 271 US 170, 70 L ed 886, 46 S Ct 449; United States v. Kirby Lumber Co., 284 US 1, 76 L ed 131, 52 S Ct 4, or if he sets up a revocable trust with income payable to the objects of his bounty, §§ 166, 167, Revenue Act of 1934, 26 USCA Int. Rev. Acts 1940 ed. p. 727; Corliss v. Bowers, 281 US 376, 74 L ed 916, 50 S Ct 336, supra; cf. Dickey v. Burnet (CCA 8th) 56 F (2d) 917, 921, he does not escape taxation because he did not actually receive the money. Cf. Douglas v. Willcuts, 296 US 1, 80 L ed 3, 56 S Ct 59, 101 ALR 391; Helvering v. Clifford, 309 US 331, 84 L ed 788, 60 S Ct 554.
>
> "Underlying the reasoning in these cases is the thought that income is 'realized' by the assignor because he, who owns or controls the source of the income, also controls the disposition of that which he could have received himself and diverts the payment from himself to others as the means of procuring the satisfaction of his wants. *The taxpayer has equally enjoyed the fruits of his labor or investment and obtained the satisfaction of his desires whether he collects and uses the income to*

> *procure those satisfactions, or whether he disposes of his right to collect it as the means of procuring them.* Cf. Burnet v. Wells, 289 US 670, 77 L ed 1439, 53 S Ct 761, supra." (Emphasis supplied.)

The Tax Court has entirely overlooked that the children through this pledge of income got something of substantial value which they contributed to the capital of the co-partnership. This, too, illustrates that the Tax Court completely lost sight of the Supreme Court's mandate to find whether the Petitioners' children were bona fide partners "because of contribution of capital of which they were the true owners".

CONCLUSION.

The record in this case shows without contradiction, that Petitioners' children were the true owners of the capital they contributed to the partnership. This fact, taken together with all the other facts in evidence, establishes that the parties really and truly intended to join together for the purpose of carrying on a business and sharing in its profits and losses. There is no evidence that the partnership was a mere sham utilized for the purpose of reducing the Petitioners' true tax liability by a pretended distribution of income. Measured by every test, the evidence discloses that the arrangement here in question fulfills all the conditions necessary to qualify it as a valid partnership for income tax purposes. The Petitioners have,

therefore, effectively carried the burden of showing the reality of their partnership.

It is submitted that the decision of the Tax Court should be reversed.

Dated, San Francisco, California,
November 10, 1950.

Respectfully submitted,
PHILIP S. EHRLICH,
ALBERT A. AXELROD,
R. J. HECHT,
IRVING ROVENS,
Attorneys for Petitioners.

(Appendix Follows.)

Appendix.

Appendix

Articles of Co-Partnership

These Articles of Co-Partnership, made and entered into this 31st day of December, 1942, by and between Floyd J. Harkness, first party; Molly A. Harkness, second party; Floyd James Harkness, Jr., third party; and Harriet Harkness Colgate, fourth party, the first, second and third parties being residents of the County of Fresno, State of California, and fourth party being a resident of Columbus, Franklin County, Ohio:

Witnesseth:

That the said parties hereto for themselves, their heirs, executors, administrators and assigns agree to become co-partners in the business of carrying on a general business of growing, packing, shipping and distributing of fresh fruit and vegetables in the State of California, including the purchasing and selling of any and all kinds of real and personal property necessary in carrying on and conducting said business, and said business shall be conducted under the firm name and style of "UNITED PACKING CO." from January 1st, 1943 until such time as the said co-partners shall mutually agree to dissolve said co-partnership, or the said co-partnership shall be otherwise as hereinafter provided dissolved, and that the terms upon which the said parties have entered into said co-partnership are hereinafter stated as follows, to-wit:

That the said business of growing, packing, shipping and distributing of fresh fruit and vegetables and any other business which shall be incidental and necessary thereto, shall be carried on in the State of California and that the principal place of business of said co-partnership shall be in the Rowell Building in the City of Fresno, County of Fresno, State of California or at any other place or places as the partners shall hereafter determine and that the firm name and style of said co-partnership business shall be UNITED PACKING CO., with real and personal property belonging thereto located in the Counties of Kern, Tulare, San Joaquin and Fresno, State of California.

It is understood and agreed by and between the parties hereto that said first party has been conducting the above mentioned business individually under the firm name and style of United Packing Co., and that he and Molly A. Harkness, his wife, second party herein, have been the owners of all the real and personal property, equipment and materials that are now used in carrying on said business, together with such moneys as may now be on deposit in the name of the said United Packing Co. and together with any and all outstanding accounts owing as of this date, the said Floyd J. Harkness and Molly A. Harkness, first and second parties herein, do by these presents, sell, convey and set over, an undivided one-fourth partnership interest in and to all of the partnership property of the United Packing Co. to each of the third and fourth parties, namely, Floyd James Harkness, Jr.,

and Harriet Harkness Colgate, and from this date on each of the said co-partners above named, shall be and become the owners of an undivided one-fourth interest of all of the property of the said co-partnership doing business under the firm name and style of United Packing Co. and that the real and personal property which shall compose the capital of the said co-partnership and belong to the newly organized co-partnership is described in a Schedule marked Exhibit "A" and attached hereto and made a part of this agreement as if herein fully set out, and that there shall also belong to said co-partnership any and all other assets which now belong to said co-partnership and are not herein described as well as any and all other assets which may hereafter belong to said co-partnership; that all thereof shall belong equally to all of the partners herein named and in consideration of said first party conveying all of said real and personal property to said co-partners being conducted under the firm name and style of the United Packing Co., and which is agreed to be of the net value of $138,241.61, that the said third and fourth party shall each execute in favor of first party a promissory note in the sum of $34,-560.40 payable in the manner as herein set forth to first party, and which sum shall be the purchase price for their undivided one-fourth interest in and to all of the assets of said co-partnership.

It is understood and agreed by and between the parties hereto that the said first and second parties are husband and wife and that all of the property which said first party is on this date conveying to the

newly-formed co-partnership, in which all of the above named parties are equal partners, has been accumulated by first and second parties during their married life and is the community property of first and second parties and that one-half thereof, by reason thereof, is the property of said second party and that the said second party does herewith join first party in the conveying of all of the said assets herein described to the said co-partnership so that from this date on, all of the said property now belonging to the said United Packing Co. and any and all other property which may hereafter belong to said co-partnership shall be owned equally by all the said co-partners.

It is understood and agreed by and between the said co-partners that said first party shall be, and is from this date on made the general manager of said co-partnership, and that he shall be in full charge of all business operations of said co-partnership and that he shall have the full right to conduct the business of said co-partnership in such manner as he may desire, including the selling of any and all of the partnership assets and the purchasing of such other property as he may desire in the name of said co-partnership together with the right to borrow such money as he may deem necessary to carry on said business and in consideration thereof it is understood and agreed that first party is to receive for his said services a certain percentage of the net profits of said business to be agreed upon between all of the partners herein from time to time as they may agree upon between them-

selves, and that the balance of the net income of said co-partnership shall be equally divided between all of the co-partners herein at such time or times as they may agree upon, provided however that any profits which third and fourth parties are entitled to receive shall be paid to first party and applied by him first, to any payment which first party may have advanced to third and fourth parties, together with interest thereon and the balance thereof, if any, shall be applied by first party in the payment of the promisory notes which the said third and fourth parties have executed in favor of first party for the purchase price of their share in said co-partnership business.

It is understood and agreed that the said first party as general manager, and any one of the other co-partners acting together shall have the right to bind the said co-partnership in such manner or form as they may deem necessary, in order to carry on the business of the said co-partnership, and that no other co-partner shall have the right to in any manner bind the said co-partnership, and that no co-partner shall have the right to in any way sell, assign, set over, transfer or hypothecate his undivided one-fourth interest in said co-partnership without first obtaining the written consent of two other co-partners.

It is understood and agreed that said first party as general manager of said co-partnership shall devote such portion of his time and attention to the conducting and carrying on of said business, as he shall deem necessary and proper but that he will at all times use

his own good judgment and best efforts and experience in carrying on said business for the best interests of all parties concerned and that second, third and fourth parties shall not devote any time or attention in carrying on said business unless hereafter agreed upon by and between any three of said co-partners and at that time it shall be agreed upon by and between any three of said partners as to what the compensation shall be for the services which third and fourth partner may contribute towards the carrying on of said co-partnership business.

It is understood and agreed that there shall be kept at all times a complete set of books of account wherein there shall be entered any and all records and transactions of said business and that the said first party shall have complete charge thereof and that said books shall be under his immediate supervision and that the said first party shall have the full charge of the collections and expenditures of all of the moneys received and taken in, in the carrying on of said business, and that all of the business transactions of said first party in carrying on said business shall be binding on all of the said co-partners.

It is understood and agreed in this connection that first party will render on the 1st of each year a true and full statement and account of the profits or losses of said business and all other matters and transactions done and performed in connection with said business.

It is understood and agreed by and between the parties hereto that upon the consent of the managing

partner and two of the remaining partners that the capital of the partnership may be increased to such sum as may be determined by them, and that thereafter each of the partners shall contribute their respective share of the capital increase. In the event the managing partner and two of the other partners desire to reduce the capital of the partnership or withdraw profits, then such determination shall become binding upon all the partners hereto.

It is further understood and agreed by and between the parties hereto that each one of the partners will not, without the previous consent in writing of the other partners, enter into any bond or become bail or security for any person or persons or do or suffer to be done anything whereby the capital or property of the co-partnership may be taken by execution and that each partner shall punctually pay his own separate debts and should any one of the said co-partners become financially involved in outside interests so that his share in the said co-partnership business shall become involved, and should any one of said co-partners in any manner so become involved then the other co-partners shall have the right to acquire such insolvent partner's right, title and interest in said co-partnership at the book value thereof without any consideration of the good will of the said co-partnership and upon such transfer, such insolvent partner shall have no further right, title and interest in and to the capital assets of the said co-partnership.

It is understood and agreed that in the event that any one of the said co-partners desire to sell or in any

way dispose of their interest in the said co-partnership business, that then the remaining co-partners shall have the right to purchase such partner's interest in said co-partnership and then the selling co-partner shall convey all of his right, title and interest in and to the said co-partnership property to the remaining co-partners, and shall receive for such conveyed interest the book value of such interest at said time without any consideration of the good will of the co-partnership and that the amount which the selling co-partner shall receive may be paid in cash by the remaining co-partners, but if the remaining co-partners do not desire to pay cash for the selling partner's interest, then they shall have the right to pay such amount by the application of the profits from the business of such selling partner's share and that the same shall continue to be paid in this manner until the said purchase price of such selling partner's interest in said co-partnership shall have been paid in full, and then such selling partner shall execute in favor of the remaining co-partners a Bill of Sale conveying all his right, title and interest in and to the said co-partnership business and assets to the remaining co-partners.

It is understood and agreed by and between the parties hereto that should any one of the partners become deceased, that then the remaining co-partners shall have the right to purchase such deceased partner's share in said business at the book value at the time of the death of such co-partner without any consideration of the good will of the partnership and such

deceased partner's interest in said business shall be paid to the legal representative of such deceased partner and then the legal representative of such deceased partner's estate shall convey all of the deceased partner's right, title and interest in and to the said co-partnership property to the remaining co-partners and the legal representative of such deceased partner shall receive for such conveyed interest the purchase price for such deceased partner's interest which may be paid in cash by the remaining co-partners or if the remaining partners do not desire to pay cash for such deceased partner's interest, then they shall have the right to pay such amount by the application of the profits from the business of such deceased partner's interest and that this method of payment shall continue until the said purchase price of said deceased partner's interest shall have been paid in full and that upon such payment in full of the purchase price of said deceased partner's interest in said co-partnership the legal representative of such deceased partner shall execute and deliver to the remaining co-partners a Bill of Sale conveying all of the said deceased partner's interest in the said co-partnership business and assets.

It is also agreed by the co-partners that in the event of any misunderstanding between the co-partners concerning the matter of conducting and carrying on of said business that then the partners shall, between themselves adjust the same; it is however understood in this connection that the decision of the general manager and one other partner hereto shall

determine any question which may arise between them and in the event that anyone or more of said co-partners should be dissatisfied with such decision then they shall have the right as given them by the laws of the State of California to bring proceedings in court for the purpose of either dissolving the said co-partnership or obtaining such relief as they are entitled under the terms of this co-partnership.

It is further understood and agreed that this co-partnership business is entered into on the proposition that each partner has an equal interest therein and is entitled to an equal share in all gains, profits and increases which shall come, grow or arise from, or by means of said business so long as such partner or partners shall not be in default in any of the terms of this agreement and that each partner shall be entitled to his one-fourth share of the said profits and that each partner shall likewise share equally in any losses which the said partnership may sustain and that each partner shall in the event it becomes necessary to furnish additional funds by reason of any losses which the said partnership may sustain, then each partner shall furnish and pay into the said business his equal share which may be necessary in order to continue on with the said co-partnership business. It being agreed that the decision of the managing partner and any two of the remaining partners shall be final as to the matter of the division of the profits and the amount which may be paid in by each partner in the event it becomes necessary to do so on account of losses sustained by the said co-partnership.

That at the end or sooner determination of their co-partnership, the said co-partners, each to the other, shall and will make a true, just and final accounting of all things relating to their said business, and in all things truly adjust the same; and that all and every stock and stocks, as well as the gains and increase thereof, which shall appear to be remaining, either in money, goods, wares, fixtures, debts or otherwise, shall be divided between them, share and share alike.

IN WITNESS WHEREOF, the above named partners have hereunto set their hands and signatures the day and year first above written.

____

First Party.

____

Second Party.

____

Third Party.

____

Fourth Party.

EXHIBIT "A"

FINANCIAL STATEMENT—UNITED PACKING CO.
1/1/43

Assets

Cash			$100,000.00
Lodi Jap Camps			428.77
Packing Sheds		$21,615.15	
	Less: Depr. Reserve	15,966.41	5,648.74
Real Estate—Parlier			1,500.00
Registered Brands			1,230.00
Auto Equipment		9,025.96	
	" "	2,925.58	6,100.38
Firebaugh Ranch		2,944.50	
	" "	1,898.24	1,046.28
Otani Tractor		1,290.56	
	" "	151.15	1,139.41
Box Making Machine		750.00	
	" "	750.00	0
Peach Brushers		2,271.11	
	" "	2,271.11	0
Paper Trays			504.18
Office Equipment		2,354.03	
	" "	1,293.03	1,061.00
Packing Equipment		12,288.81	
	" "	8,976.86	3,311.95
Picking Boxes			6,182.60
Packing Materials			6,473.31

Accounts Receivable:				
	Andrews Bros.		164.50	
	Benner Tea Co.		2,365.00	
	H. H. Bennett		222.30	
	Mrs. Blazer		575.00	
	P. V. Cervantes		40.00	
	P. B. Elter		74.45	
	Goodman Vyd.		325.00	
	M. Kozuki		519.03	
	Mrs. Okjima		811.97	
	Pete Dawson		2,430.00	
	Ray Stevens		262.78	
	Mrs. W. J. Welsh		444.40	
				8,234.43
				142,861.03
Liabilities				
Reserve a/c			$ 3,959.02	
Accounts Payable:				
	Max Arnold	16.95		
	J. Harkness	20.00		
	L. Powers	593.45		
	H. Schwaegler	30.00		
			660.40	
				4,619.42
Capital				
F. J. Harkness, Sr.			$34,560.41	
Mrs. M. A. Harkness			34,560.40	
Harriet Harkness Colgate			34,560.40	
F. J. Harkness, Jr.			34,560.40	
				$138,241.61
				$142,861.03